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# Germany

Touche Ross International

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business study

**germany**

*Touche Ross International*



business study

# **federal republic of germany**

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*Touche Ross International*



# Preface

This study is one of a series of Business Studies designed for the use of Touche Ross professional staff in all countries and for interested clients. Users of the study should ascertain whether the information given here has been superseded by later developments. Specific business questions or problems may have legal and tax ramifications that are beyond the scope of this Business Study and the assistance of professional advisers is recommended. Suggestions for revisions should be sent to the Touche Ross International Executive Office.

The amounts quoted in this Business Study are in Deutsche Marks (DM). At 31st December 1976, the approximate Deutsche Mark exchange rates with other currencies were:

DM1=	US\$	0.42
	Pounds Sterling	0.25
	French Francs	2.10
	Swiss Francs	1.04
	Japanese Yen	125.00
	Dutch Guilders	1.04

Readers should check for any subsequent variations in these rates.

December 1976





## Introduction

The official title of the western part of Germany is the Federal Republic of Germany. In this Business Study, it will be referred to as Germany, unless the context requires otherwise. West Berlin is joined with the Federal Republic in economic, legal and financial matters; therefore, a chapter on the city has been included. The German Democratic Republic, which is the eastern part of the country and is under Soviet influence, is not covered in this study.

Germany is an impressive country, and a large part of central Europe is inhabited by German-speaking peoples. German words are sometimes difficult to translate into other languages, but perhaps two of them indicate why the country is outstanding as a nation. *Tüchtigkeit* suggests efficiency, devotion to duty, pride in one's work. And this striving after perfection, this inability to relax is an aspect one associates with the strong Teutonic character. A lighter aspect of their nature can perhaps best be described by that other word, *Gemütlichkeit* — a splendid word which implies friendliness, good-fellowship, the lightheartedness of a wine festival in a Rhine village, the sociability of a Bavarian beer-cellar. Two words — two aspects of the highly complex German character.

In 1941, Adolf Hitler, by marching against Russia, brought Soviet armies far into the country, effectively splitting it between east and west. Another man, four hundred years earlier, through religious convictions, had also deeply divided the country. Martin Luther, by revolting against the Catholic Church, caused a schism between north and south; and today there are many differences between the inhabitants of Hamburg in the northwest, for instance, and the people of the Bavarian alpine villages in the southeast. Nonetheless, the Federal Republic of Germany is a unified, progressive state. It is the country of the 'Economic Miracle,' where hard work, perseverance, and a determination to overcome immense obstacles made it possible to rebuild the

nation's fabric. It was an awesome task, but once again West Germany's economy is one of the most significant in the world. Despite the 1974/75 recession and fears of lower profitability, the country enjoys a favorable international investment climate.

This Business Study was written by G.K. Dykes and J.A. Newman of the Touche Ross office in London, England, with the active cooperation of H. Schnitzler and the late W. Helmling of Touche Ross, Frankfurt/Main.

Linda S. Avelar  
Director of International Publications  
December 1976



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- THE COUNTRY
- THE PEOPLE
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## THE COUNTRY

### Natural Features

The Federal Republic of Germany lies at the centre of Europe: the distance from its commercial capital, Frankfurt-on-Main, to the north of Sweden, Gibraltar, and the Greek islands is about the same. On the north, the Danish peninsula separates Germany's North Sea and Baltic Sea coasts, and to the south are Switzerland and Austria. To the east are East Germany (the German Democratic Republic) and Czechoslovakia, and to the west France and the Benelux countries. The frontiers are not always marked by physical features, except in the southwest by the River Rhine, and in the south and east by various mountain ranges. The frontier with East Germany follows old administrative boundaries, dividing villages and crossing rivers.

The territory of the Federal Republic, including West Berlin, covers an area of 248,500 square kilometers (96,000 square miles). This is about the same area as that of the State of Oregon, USA, or a little more than the United Kingdom. It is geographically divided into the North German Plain, which forms part of the great European plain extending across the Continent; an undulating central area extending from Belgium and Luxembourg in the west to Czechoslovakia in the east; the Southern uplands, which include the Black Forest hills in the southwest and the Bohemian Forest in the east; and the Alps and their foothills along the Swiss and Austrian frontiers.

### Climate

The climate is moderate in summer and winter. Temperatures average between 15° and 20°C (60° and 70°F) in summer and 0° and minus 10°C (32° and 17°F) in winter. The milder marine climate of the northwest becomes less temperate and more variable toward the south, and in Bavaria, particularly, abrupt weather changes are often experienced. Normally, it rains in the early part of the winter in the north and in the summer in the south, with this summer rain frequently accompanying storms and quickly drying out. Between December and March, it often snows, especially at higher altitudes, and in the south-east, temperatures fall below freezing point for three months of the year, but often reach 27°C (80°F) in the summer.

# Germany in Brief

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## Natural Resources

The country's natural resources are comparatively modest in variety and amount, except for coal deposits, the biggest on the West European mainland. Bituminous coal reserves, the basis of the iron and steel industries of the Ruhr, the Aachen area, and the Saar, are now largely used for the production of electricity. In recent years, the coal mining industry has not been able to compete with other producers of primary energy. Hydroelectric power is produced in the south. There are potash deposits in the Hanover area, and other minerals found are iron, zinc, lead, copper, and salt. Some petroleum and natural gas are produced. Germany has a sector of the North Sea, but to date no oil or gas reserves have been discovered there. Agriculture, favoured by fertile soils especially in the north, meets about three-quarters of the domestic food needs, making Germany the second largest agricultural producer in Europe. In the south, timber is widely grown.

## Major Cities

The principal cities are:

Population (millions)		Population (millions)	
West Berlin	2.1	Dortmund	0.7
Hamburg	1.9	Stuttgart	0.6
München (Munich)	1.3	Bremen	0.6
Köln (Cologne)	0.9	Hannover (Hanover)	0.6
Essen	0.7	Nürnberg (Nuremberg)	0.5
Düsseldorf	0.7	Duisburg	0.5
Frankfurt/Main	0.7	Bonn (federal capital)	0.3

Most place-names are the same in German and in English; where they differ, both versions are shown in the above list. For ease of reference, the English spelling will be used throughout this study.

West Germany consists of five main areas:

1. The North, which contains the major seaports of Hamburg, Bremerhaven, and Bremen and other cities such as Kiel, Lübeck, and Hanover. The ports handle a large volume of international sea-borne trade.
2. The Ruhr, a concentrated heavy-industry area where cities such as Essen, Dortmund, Mülheim, and Gelsenkirchen almost run into one another. On the Rhine nearby are Duisburg (Europe's largest inland port), Düsseldorf, and Cologne. This highly populated area is often used as a test-market for new products.

3. Frankfurt-on-Main, the chief banking and commercial centre. Frankfurt, together with cities to the south such as Mannheim and Stuttgart, forms a prosperous industrial area.
4. Bavaria, in the southeast, largely agricultural but noted for its scenery and for cities such as Munich and Nuremberg.
5. West Berlin, the largest city in Germany, with many industries and a ready-made market for consumer goods.

## THE PEOPLE

### Population

In 1974, the population of Germany including West Berlin was about 62.5 million. Population density averages 250 per square kilometer (645 per square mile), about 10% less than Japan's and 10% more than the United Kingdom's, but this density varies widely, with about a quarter of the population concentrated in the heavily industrialised Ruhr area. Since 1972, the annual rate of increase has been less than one percent and is decreasing. The huge influx of refugees from the East after World War II has now been almost totally absorbed into West German society.

### Labour Force

West Germany's labour force of about 26 million is highly efficient and has one of the world's top production rates.

Recent official statistics showing the distribution of the labour force indicate principal activities as follows:

	000	%
Agriculture and forestry	1,726	6.6
Power, water and mining	514	2.0
Manufacture	9,744	37.5
Construction	1,812	6.9
Transport and communications	1,513	5.8
Commerce and trade, banking and insurance	3,867	15.0
Services	3,904	15.1
Public administration and social insurance	2,491	9.6
Other	389	1.5
	<u>25,960</u>	<u>100.0</u>

The trend for some years has shown movement from agriculture into industry, commerce and trade.

# Germany in Brief

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## Language

The language is German, although dialects exist in various parts of the country. Most younger people, and many businessmen at high levels of industry and commerce, have a fair command of at least one other European language – often English.

## Education

The country was a pioneer in compulsory education, and standards are high. Obligatory attendance at a school up to the age of 15 makes it difficult to find an illiterate. Primary and secondary schools, colleges and universities are almost all free. Admission to a secondary school at age 10 is normally by examination. For a college or a university, a secondary school certificate is required. This certificate can also be obtained by attending special schools or evening courses and passing the qualifying examination. For those who enter trades as apprentices, and do not hold the secondary school certificate, attendance at elementary technical schools is mandatory. To supplement the work of these schools, large corporations often maintain their own training centres. For retraining for another trade or profession, state grants are available.

## Religion

About 49% of the population, mainly concentrated in the north, is Protestant, and about 45%, principally in the south, is Roman Catholic.

## History

One of the earliest references to the country is by the Roman historian Tacitus, who wrote "Germania" in A.D. 98, although Rome never subdued the country, except for the area south of the Danube and west of the Neckar and Rhine. By the eighth century the barbarians whose invasions destroyed the Roman Empire had settled down and on Christmas Day in 800 A.D. the Frankish King Charlemagne, who controlled the whole of western and central Europe, was crowned a new Roman Emperor. On his death his empire split into western and eastern parts (France and Germany respectively) and a short-lived middle kingdom. In the east a number of local dukedoms emerged that conducted fierce struggles against the centralising ambitions of successive kings. The Saxon Otto 1 managed to consolidate royal power in alliance with the church and extended his domains to Italy, where he was crowned Holy Roman Emperor in A.D. 962. This empire continued until 1806 when it was dissolved by Napoleon. But the local princes, dukes, counts and bishops all assumed degrees of independence and central Europe became a loose federation of small states and cities under the rule of one prince who, by tradition, was crowned emperor



by the Pope. The history of Germany thus became largely one of petty rivalries and small ambitions in states lacking common purpose and having, apart from a common language and a nominal allegiance to the emperor, little common bond. This is why Germany made no political advances on the world stage in renaissance and later times as did the centralised monarchies of Spain, France and England. Nonetheless, in the fields of arts and crafts, Germany's contributions were outstanding; for example, it was at Mainz that Gutenberg first produced a printed book.

Although the title of emperor was not hereditary, it gradually came almost continually into the hands of the Habsburg family whose personal domains (although at one point including Spain, the Netherlands and parts of France and Italy) were in Austria and the southeast. The calamitous religious struggles of the Thirty Years' War in the seventeenth century strengthened the Protestant states of the north and gradually restricted Habsburg and Austrian influence to the south. In the 18th and 19th centuries the northeastern kingdom of Prussia became dominant and, having defeated Austria in a short war in 1866, assumed the leadership of the German-speaking states. In 1871 the Prussian king was elected Emperor of Germany, but even then the country remained a federation of monarchies and it was not until 1919, after World War I, that the German Republic was founded as a centralised state.

The burdens and restrictions of the peace-making of 1919 followed by the world economic crisis of 1929-32 and resulting huge unemployment led to extreme nationalism, and ultimately to World War II. This ended in the total occupation of the eastern zone by Russia and of the western zones by the Western powers. In 1949 the western zones adopted a new constitution whereby ten states (*Länder*) became a democratic federation as the Federal Republic of Germany. West Berlin has a special status and is a self-governing adjunct of the Federal Republic.

In 1951, Germany was one of the founders of the European Coal and Steel Community, the forerunner of the European Economic Community (EEC) or 'Common Market.'

## **Life in Germany**

At seven in the morning, the streets are already filled with traffic, for Germans start their day early. They are an industrious people, well organized and thorough, although somewhat impatient, doing nothing by halves.

# Germany in Brief

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The industrial revolution came late to Germany, but developed rapidly; this fact together with wartime destruction may account for the few city slums such as those in countries that industrialised earlier, like Britain, France and Belgium. Also, nowhere is there a visible working class — good clothing, cars, foreign travel, and other material advantages are widespread. There is roughly one car, telephone, radio, and television set for every three inhabitants.

The German landscape is varied. Much of the countryside and many of the towns and cities are attractive, often containing reminders of Central Europe's medieval, renaissance and baroque heritage. Palaces, castles and churches add colour and variety to town and country alike, and there are museums and concert halls in many cities. German beers and wines are famous. Family life is held in high regard. Germans have a wide variety of interests, and sports are among them. Both summer and winter sports are popular, although golf, tennis or other clubs are not used for business entertaining.

Houses and apartments (flats) may be rented or bought, although prices tend to be high; in the cities, apartments are more common. Mortgage banks offer finance for home-purchase, although house construction cooperatives offer less expensive facilities for long-term savers. Foreigners must observe their own countries' exchange control regulations before considering a purchase. Domestic equipment purchases are widely financed by hire-purchase contracts.

There are schools for foreigners' children in several of the larger towns, although these cater primarily to Americans.

## GOVERNMENT AND THE ECONOMY

### Executive and Legislative Powers

The 1949 constitution created the organs of the Federal Republic: they are the Parliament (*Bundestag*); the Council of States (*Bundesrat*); the Government, headed by the Chancellor (*Bundeskanzler*); and the President, who has no political power. The Federal Parliament is elected by universal adult suffrage (from age 18) for four years, has legislative powers, elects the Chancellor, and controls the Federal Government. Half the members of the Federal Parliament are directly elected, and half are appointed from party lists so as to make party strengths proportionate to the total poll (very small splinter parties excepted). Twenty-two deputies represent West Berlin, but are not entitled to vote. The Federal Council of States can initiate legislation, although it has only limited powers of veto or delay; however, certain federal laws and statutes, financial ones especially, require its consent. The constitution defines the principles of democratic and social order in the

country, the separation of legislative, judicial, and executive powers, and the distribution of political power between the Federal Government and the states.

Most German law is set out in a series of codes, which are statutes designed to deal comprehensively with the subjects concerned. Judges interpret the law, but cannot add to it by stating new principles in their judgements.

The commercial and industrial departments of the government are the federal and state Ministries of Economics and Finance. Prospective investors requiring information usually contact the local offices of the chambers of commerce described in Chapter 3 rather than these government departments.

## The Judiciary

The constitution created a system of federal and state courts. Appellate courts are state bodies, but supreme jurisdiction is exercised by the Federal Constitutional Court, the Federal Supreme Court, and the Federal Fiscal Court. At a lower level, there are local, district, and regional courts of appeal. In addition, there are separate tax, social security, and labour courts, the latter two headed by the Federal Court for Social Matters.

## State and Local Government

Each of the ten states constituting the Federal Republic has its own elected assembly, cabinet, and president, and retains certain powers and duties. The states are:

	State Capital	Area (000 Sq. Km.)	Population (millions)
Schleswig-Holstein	Kiel	15.7	2.6
Hamburg	Hamburg	0.8	1.9
Bremen	Bremen	0.4	0.6
Niedersachsen (Lower Saxony)	Hanover	47.4	7.3
Nordrhein-Westfalen (North Rhine — Westphalia)	Düsseldorf	34.0	17.4
Hessen (Hesse)	Wiesbaden	21.1	5.6
Rheinland-Pfalz (Rhineland-Palatinate)	Mainz	19.8	3.7
Saarland (Saar)	Saarbrücken	2.6	1.1
Baden-Württemberg	Stuttgart	35.7	9.3
Bayern (Bavaria)	Munich	<u>70.5</u>	<u>10.9</u>
		248.0	60.4
West Berlin	West Berlin	<u>0.5</u>	<u>2.1</u>
		<u>248.5</u>	<u>62.5</u>

# Germany in Brief

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Some states are subdivided into regional districts — for example, six in North Rhine-Westphalia and seven in Bavaria.

Each district controls the issue of residence and other permits, but first application on most permit matters should be made to the officials of the local community or *Gemeinde*.

## Political Parties

At present, the larger political parties are the Social Democrats (SPD), the Christian Democratic Union (CDU), and its Bavarian equivalent, the Christian Social Union (CSU). The Social Democrats together with the Free Democrats (FDP), a small party, currently form the majority in the Bundestag and therefore constitute the Government. The present Chancellor is Hr. Helmut Schmidt.

## Economic Trends

Postwar reconstruction and development of the economy were based on a currency reform of June 1948, which provided for a conversion rate of 6.5 Deutsche Marks to 100 old Reichmarks. Existing economic controls were removed and the free market system was successfully introduced. At the same time, a property levy, payable with interest, by individuals and businesses over a period of 30 years, was raised to equalise the burden of war losses. The country's subsequent growth was largely initiated by foreign aid and loans (the Marshall Plan).

The advances of the 1950's and 1960's are evidence of Germany's favourable economic policy, although to some extent they resulted from advantageous exchange rates, and the determination and ingenuity of the German people. The growing surplus of exports over imports necessitated considerable increases in the exchange value of the Deutsche Mark from time to time. Despite this, exports continued to increase, and reached about one-fifth of total sales in 1974. In 1975, however, due to the worldwide economic recession, exports dropped by 17.5% and unemployment rose to 1.3 million in early 1976, at which time inflation was being held at 5.9%. The Federal Government and West German economists believe that slight improvements may be expected in 1976 since the economy is in general sound. Germany's chief trading partners are France, the Netherlands, the USA, Italy, and Belgium/Luxembourg.

## Significant Statistics:

	1971	1972	1973	1974	1975
Gross national product					
Current prices (billion DM)	762	834	927	996	1,040
Constant prices (1962)					
(billion DM)	545	564	593	595	575
Real increase (%)	3.0	3.4	5.1	0.4	(3.4)
Exports (billion DM)	136	149	179	231	222
Imports (billion DM)	120	129	145	180	184
Industrial production					
(1970=100)	102	106	113	111	104
Wages (1970=100)	111	121	135	150	162
Cost of living index					
(1970=100)	105	111	119	127	135

A government investment programme designed to stimulate the economy was introduced in August 1975.

## Foreign Investment

The country's strong economy and its central position in European markets have been major attractions for foreign investment. At the beginning of 1974, foreign long-term investments amounting to nearly DM 50 billion were held in over 11,000 commercial enterprises, with about 17% of all sales being derived from such investments. The USA was then the major investor with about 43% of the total, Germany being second only to the United Kingdom as the objective for USA investment. Investment through Switzerland came next with about 13%; followed by the Netherlands with 12%; the United Kingdom, 11%; and France, 6%. The Netherlands led with investments in new projects in 1975.

There is some foreign investment in nearly every branch of industry and trade. One source recently indicated that foreign participation in the oil industry is about 79%; in electronics and electrical equipment, 40%; in metal production, 37%; in chemicals and rubber, 32%; in mining, 24%; in steel, machinery, and automobiles, 22%; in foodstuffs, 19%; and in general distributive trade, 11%.



## CHAPTER II

# Investment Factors

- INVESTMENT INCENTIVES
- FORMALITIES AND PROCEDURES
- SOURCES OF FINANCE
- CONTROLS OVER FOREIGN EXCHANGE
- STATE DEVELOPMENT AGENCIES

Germany's attitude to foreign investment and trade is liberal. The Foreign Trade Law of 1961 states that foreign trade must be unimpeded, unless special reasons exist making restrictions necessary, and that such restrictions must be lifted immediately the reasons for their imposition no longer apply. Even when in the early part of the 1950's an influx of capital began, specifically from the United States, the government declined to modify the principle of freedom of investment. Like any German investor, a foreigner must observe the commercial law and regulations concerning foreign trade, cartel law, and business in general.

In addition to the choice of form of any proposed investment, another factor to be considered, in the light of investment incentives offered, is its location and, if important, the availability of labour. Forms of business entities are explained in Chapter 6 and labour factors in Chapter 4.

### INVESTMENT INCENTIVES

#### Attitude to Foreign Investment

Any foreign enterprise may establish itself in Germany, either as a branch or through a subsidiary company. Government intervention in economic affairs has in the past been limited, but it is growing, and some restrictions of owners' rights, described later in this chapter, could cause concern to big investors.

Germany is a steadily expanding market for most products. Its economy is strong despite occasional downturns, and its currency is one of the world's hardest, with foreign exchange controls held to a minimum. It is well situated for distribution to neighbouring EEC countries, Scandinavia, Austria, and Switzerland; and its internal and external communications are good.

Germany is a signatory to the 1965 Convention on the Settlement of Investment Disputes under which an International Centre for Arbitration and Conciliation was set up as a department of the World Bank. The centre is available to help resolve differences concerning investment projects, where one party is a government or government agency and the other a foreign national.

# Investment Factors

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## Tangible Investment Incentives

Investment incentives are available from federal and state government agencies. They are granted to both domestic and foreign enterprises that erect new plants and buildings or expand existing manufacturing facilities, if additional employment is created. Generally, incentives are offered only in certain areas, as listed in the Federal Gazette. They are mainly in West Berlin, the Ruhr, and Saar coal-mining areas, the border zones, tourist centres, and in a number of rural areas where industrialisation is particularly promoted. Incentives include grants for capital expenditures and special subsidies, described in more detail later in this chapter, and tax concessions, described in Chapter 8. Incentives are governed by four special laws and additional regulations that change from time to time. The additional incentives, including tax concessions, available in West Berlin are described in Chapter 9.

**Rates of Assistance.** Areas approved for promotion are grouped into three categories, for which maximum rates of assistance for capital expenditure of 25%, 20%, and 15% (including tourist centres) are provided. Outside these areas, if the economic structure is to be substantially improved by a proposed project, such a project may be subsidised by up to 10%.

In all these cases, the assistance includes a 7½% cash grant (*Investitionszulage*), which is available from the Federal Ministry for Economic Affairs for investments in plant, machinery, or equipment (but not land). The remaining portion of the incentive up to the rate approved for the project concerned, limited to the maximum rate stated above, is provided by the State Ministry for Economic Affairs for the area in which the project will be carried out. This extra grant from the state (*Investitionszuschuss*) is based on a common programme of the federal and state governments. Such grants should be applied for before the start of any project.

The state governments maintain special development agencies to encourage investment. For example, North Rhine-Westphalia, although one of the richest of the states, contains older industries in the Ruhr coal-mining area, and for this reason is just as interested as the other states in attracting foreign investment. The offices of the state development authorities are listed on page 25. While investment is encouraged, application procedures are very time-consuming, and in general, foreign investors are usually more inclined to purchase existing enterprises than to build their own.

It is important to note that federal capital grants (*Zulage*) are not taxable, but state grants (*Zuschuss*) are, as described in Chapter 8.

**Conditions for Assistance.** An enterprise must be able to prove that its project warrants promotion by the government; there is no legal right to investment grants. Incentives are negotiable up to the indicated maximums, and the amount of any subsidy that can be obtained for an individual project depends on the extent to which the following conditions are met:

1. The number of workplaces for existing businesses must be extended by at least 20% or 50 workplaces (hotels, a 20% increase in number of beds). This is the primary condition for obtaining incentives.
2. The subsidised asset must remain in the beneficiary's possession for at least three years, and buildings must be used not less than 90% for the beneficiary's own purposes.
3. The goods to be produced or the services to be rendered must largely be sold to customers outside the area where the investment is to be located, so that the income of that area will be substantially increased.
4. The cost of each new workplace must not exceed 30 times the average cost of other workplaces subsidised in that area in the last three years.
5. Competitors situated in the area must not be put to serious disadvantage.
6. Incentives are not available for mere replacement of assets, nor for schemes which have an adverse effect on the local economy, nor generally for the relocation of activities at present carried on in West Berlin.
7. Companies or groups able to finance their own investments are less likely to be granted government aid.
8. The maximum amount subsidised for any one project is DM 100 million within a three-year period.

**Types of Aid.** The assistance given for investment in plant, machinery, and equipment consists primarily of the federal cash grant already described. The circumstances and procedures under which the states provide the additional part of the assistance vary. In addition to extra cash grants, guarantees are often given of loans raised to finance such assets, or subsidies are given to reduce the interest charges on such loans.



# Investment Factors

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In cases where investment subsidies are given, freight subsidies may also be granted if development in remote sites results in extra-heavy transport costs. Furthermore, subsidised manufacturing plants are given some priority when public orders are placed.

Other types of aid, unconnected with the investment subsidies and not limited by regional restrictions, are:

1. Research and development. The acquisition anywhere in the country of new depreciable fixed assets for use in research or development is subsidised by a 7½% grant from the federal government.
2. Antipollution aids. Subsidies are granted by state governments for investments that reduce air or water pollution.
3. Power-saving investments. A 7½% grant is given under a special procedure for such investments approved by the Federal Ministry for Economic Affairs.
4. Labour assistance. In some cases, an enterprise can claim an employment premium or grant when engaging workers, as when engaging long unemployed workers, for instance. Coal miners transferred to other jobs are eligible for loans for assistance in relocation and retraining.

In addition to these incentives for individual enterprises, any costs incurred by municipal authorities in the development of land, provision of utilities, construction of roads, or similar infrastructure work are subsidised by nonrepayable grants from the federal government.

## Restrictions on Investment

**Existing Measures.** Germany has numerous controls designed to safeguard health and amenities and to restrict the activities of unqualified persons. Certain industries (for example, food, pharmaceutical and medical products, transport, banks, insurance companies, handicrafts, restaurants, and hotels) require special licences. Proof of the qualification or reliability of those concerned must be produced; without such proof, an examination conducted by a chamber of commerce or other body must be passed.

These controls are unlikely to create obstacles to any soundly based schemes, but prospective investors should enquire in all cases at the local trade supervisory office or chamber of commerce regarding the

formalities to be observed. Furthermore, as in most European countries, various industries are run by government bodies, and private investors are rarely allowed to compete; examples are the state railways, most public utilities, national postal and telephone systems, and radio and television services.

**New Trends.** In 1973, the federal government proposed a 'property accumulation plan' and a 'parity co-determination plan.' The unrealistic property accumulation plan, which would have required compulsory allocation of part of a business' profits to its employees to give them ownership rights, has been withdrawn. The original parity co-determination plan has been modified, and now provides that the supervisory board of limited liability enterprises (mainly AG's and GmbH's) with more than 2,000 employees is to comprise an equal number of members elected by the shareholders and the employees. The employee members include representatives of the key managing personnel. In stalemate situations, the chairman elected by the shareholders will have a casting vote, and because of this ultimate control by the shareholders, the new rules are often referred to as the 'parity-minus law.' The law is to be introduced over a period beginning on 1st July 1976.

## FORMALITIES AND PROCEDURES

### Rules Applicable to New Businesses

The authorities of the state concerned require certain formalities to be observed before any new enterprise can be started or an existing enterprise purchased through the medium of company, branch, or partnership.

1. The proposed enterprise must first be reported to the local supervisory agency for business and trade (*Staatliches Gewerbeaufsichtsamt*). This is an office of the Ministry of Economics of the state concerned, which will decide whether there is any objection to the proposal for commercial, environmental, or other reasons. If not, a certificate of registration (*Gewerbeanmeldeschein*) will be issued.
2. The proposed enterprise must then be reported to the municipal trade tax office and the local tax office (*Finanzamt*).
3. Every new enterprise must be entered in the Commercial Register (*Handelsregister*) maintained at the local court (*Amtsgericht*) of every large town and city. Registration is normally one of the duties

# Investment Factors

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of the public notary concerned with the establishment of the new enterprise, as described in Chapter 6. Notice of registration is also published in the Federal Gazette (*Bundesanzeiger*).

4. The new enterprise must be reported to the central bank of the state concerned (*Landeszentralbank*). Such reporting is necessary even on a partial acquisition by a nonresident or on the provision of equipment or working capital, but is not required if the investment does not exceed DM 10,000 per annum in any form.

5. As soon as employees are engaged, the enterprise must be reported to the local social security office.

6. Every business enterprise is required to join the chamber of commerce in the area in which its head office is situated. A small annual fee is required for membership.

7. Special licences must be obtained for certain industries and manufacturing operations as indicated previously.

8. Any foreign corporation from outside the EEC intending to establish itself in Germany as a branch must obtain a permit from the Economics Ministry of the state concerned. Foreign individuals planning to work in the Federal Republic must obtain various documents, as described in Chapter 4.

**Powers of Attorney.** For the formation of a German company or branch, and for other legal transactions, a foreign entity is required to issue to its representative in Germany a power of attorney that evidences not only his authority to act but also the existence of the issuer and the authority of those signing it. The power of attorney must be certified in the country of origin by a notary or similar official and, in order to comply with German legal formalities, be legalised by a German consulate.

## Status of Foreign-Owned Businesses

There is no discrimination against foreign investment. A foreigner may conduct his business through a branch or subsidiary without German participation in either ownership or management; he may take over or invest in an existing business; or he may participate in a joint venture. There are no special rules to be followed by a foreign enterprise, nor are there any restrictions on the foreign ownership of land or buildings or any other property. A foreigner need not become resident in Germany to conduct his business there, although when not in the country he

must appoint a resident representative responsible to the authorities. There are no objections to the employment of skilled foreign managers, engineers, or other staff provided entry formalities have been complied with.

## SOURCES OF FINANCE

German companies tend to be highly geared, much of their finance coming from long-term borrowings. The chief sources of loan capital are the commercial savings and mortgage banks whereas sources of equity capital are private investors (personal or corporate) or banks, through which access to a stock exchange or other sources can often be obtained. As banks also provide substantial short-term capital, their importance as capital suppliers is great. Family-owned and other unquoted companies, however, depend largely on private individuals as major suppliers of risk and loan capital. Although not normally available to newly-established businesses, retained profits are a very important source of capital in Germany.

### Banks

The Federal Republic's central bank is the Deutsche Bundesbank, located in Frankfurt-on-Main.

About one-third of the total business of all German commercial, savings and mortgage banks and specialist finance institutions is conducted by publicly or privately owned credit institutions. The other two-thirds are handled by state-owned and cooperative credit institutions. The first group includes the three big banks (Deutsche Bank, Dresdner Bank, and Commerzbank), which between them share 10% of the total business and maintain numerous branches throughout the country. It also includes regional banks, branches of foreign banks (notably in Frankfurt), and private banks. The larger banks in this group have close connections with foreign banks, thus giving their customers access to international facilities.

The second group includes about 760 savings banks, headed by 12 central giro institutions which usually act as state banks (*Landesbanken*) with a supreme organisation in Berlin and Frankfurt, and more than 2,000 cooperative credit unions (*Volksbanken*) and agricultural cooperative institutions with 13 superior central institutions headed by the German Cooperative Bank in Frankfurt. The state and cooperative banks in this second group have fewer international connections.

# Investment Factors

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Both groups conduct most kinds of banking business and offer current or checking account facilities, take deposits, and provide business and personal finance. With the exception of the small local savings and cooperative banks, both groups also underwrite share or loan issues and deal on the stock exchange on behalf of their customers.

All banks are supervised by a special federal agency to which they must submit periodic financial reports. The main centre for banking is Frankfurt-on-Main, but Düsseldorf, Hamburg, and Munich are also important centres.

## Types of Bank Finance

Bank finance is available to finance manufacturing, warehousing, importing or exporting operations, and sometimes for capital expenditure. The banks provide short-term credit (up to one year) or overdrafts, medium-term loans (ranging between one and four years), and long-term loans (four years or more). Credit, normally secured, is limited by the credit rating of the borrower. Discounting of trade bills and acceptance credits is widely practiced and is fairly cheap as compared to overdraft rates. The discount rate averages  $2\frac{1}{2}\%$  to  $4\%$ , including commissions, over the federal bank rate which is at present  $3\frac{1}{2}\%$ . The discount rate depends on the credit rating of the borrower and on whether the bill can be rediscounted with the federal bank. Plant, inventories, receivables, or guarantees may be accepted as security for credits. Mortgage loans may be granted by those banks that are permitted by the bank supervisory agency to take real property as security. In addition, there are a number of special mortgage loan banks, either privately or state-owned, that provide long-term loans secured on real estate, both commercial and domestic. Floating charges over the whole of a borrower's assets are not allowed in Germany, since a charge of this nature would, under the Civil Code, make the lender liable for the whole of the borrower's debts.

The banks determine, at their discretion, the interest rates on deposits and loans. Each month, the Bundesbank publishes the average rates of interest charged and allowed by the banks. In times of currency crisis, special restrictions may be applied.

Banks are unlikely to take equity interests in newly established businesses.

## Banking Customs and Payment Procedures

The giro system, which was developed in Germany, is widely used for making account transfers between banks. Other giro systems are main-

tained by savings banks and the post office. Every holder of a bank account or similar account has access to these systems, and both domestic and foreign payments can be made cheaply and without risk by means of transfer orders. For these reasons, payments by cheque, while often made, are not as common as in some countries. For travellers, the Euro-cheque system, which is available throughout the country to holders of European bank cheque cards, facilitates matters. Banks usually credit interest at very low rates on current (checking) accounts, but make charges for operating them.

A bank statement is sent to the account holder whenever his account moves. Banks do not return paid cheques to the issuers, but retain them as part of their own records.

All banks offer a service to depositors of securities; not only do they hold the certificates and arrange for collection of coupons for dividends, but they also obtain for their customers copies of annual accounts and other documents, give them notice of meetings, issues of capital, or other significant events, and act as proxies.

## **The Stock Exchanges**

The stock exchange in Frankfurt is the largest in the country, closely followed by that in Düsseldorf, and there are small exchanges in six other major cities — Berlin, Bremen, Hamburg, Hanover, Munich, and Stuttgart. Each exchange is run by a stock exchange committee and is supervised by the state in which it is situated. All trading on German stock exchanges is conducted through banks; state-appointed brokers act as dealers.

The number of securities listed on the stock exchanges is comparatively small, and dealings in government bonds are far more numerous than dealings in commercial bonds or in equities. As in many other countries, especially in Continental Europe, the stock exchanges in Germany do not act as major suppliers of risk capital in the way that North American and United Kingdom exchanges do, particularly as those enterprises organised as GmbH companies described in Chapter 6 do not have access to the stock exchanges for equity capital. The issue of bonds (*Anleihen*) or debentures (*Schuldverschreibungen*), whether quoted or not, must be approved by the federal and state governments, but the issue of other securities does not require government approval. In addition to German corporations, many foreign corporations of high standing have obtained stock exchange quotations, and German residents may purchase domestic or foreign securities without restriction. The German subsidiaries of foreign enterprises are unlikely to raise finance, either by share or loan issues, on the stock exchanges.

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**Listing Requirements.** The stock exchange authorities are very strict in their consideration of corporations applying for a quotation, but the general requirements for a listing are:

1. Par value of the corporation's share capital must be at least DM 500,000.
2. Shares must be fully paid and are as a rule in bearer form, except for some registered shares, such as those of insurance companies, which may be in partly paid form.
3. A sufficient number of shares should be available for trading, although no minimum has been set.
4. The corporation should have been in business continuously and successfully for not less than 5 years, and should have distributed reasonable dividends during that time.
5. Method of printing share certificates should offer adequate protection against falsification.

Although not a requirement for listing, it is usual for large corporations to publish interim reports. These normally take the form of quarterly statements published in the financial press.

The application for listing must be filed by a bank or credit institute that is a member of the stock exchange concerned. Bonds may be listed even though shares are not. The application must state which securities are already listed on a stock exchange; it must confirm the publication of the application and of the approved prospectus in the stock exchange gazette; and it must be accompanied by the following documents:

1. Prospectus.
2. Evidence of the legality of the issue (usually the resolution of stockholders).
3. Copy of the registration in the commercial register showing purpose of application (for example, increase of share capital).
4. Articles.
5. Annual reports for the last three years.

6. Specimen of the share certificate to be issued.
7. Confirmation that no liabilities nor present or future events such as pending litigation or impending expiration of patents exist that have not been reported in the prospectus.

All these provisions apply also to the listing of securities of foreign companies. Registered shares of foreign companies are traded indirectly through a clearing body called *Deutschland Auslandskassenverein AG (AKV)*.

**Prospectus.** The prospectus includes:

1. History of the corporation.
2. Purpose or object of the corporation.
3. Capital history, amount of nominal value and classification of share capital, details of shares about to be issued, special rights vested in the different types of securities issued, holdings by other enterprises of more than 25% of the share capital, and summaries of intercompany agreements.
4. Members of management and supervisory boards.
5. Provisions of articles regarding calling of general meetings and voting powers, financial year, publication of announcements, dividend-paying offices and coupon depositories (bearer shares being usual), and appropriation of profits.
6. Data on dividends paid within the last five years and, in the event of losses, how these were dealt with. The last financial statements or consolidated financial statements must be set out, and may not be older than 13 months. If 8 months have passed since the last balance sheet date, an interim balance sheet to a date not more than 4 months before the prospectus date must be included.
7. Comments on major items in the balance sheet stating long-term debts with terms and conditions, contingent liabilities not provided for in the balance sheet, substantial investments, operating conditions, and information concerning the work force.
8. Description of the business and its operations.



# Investment Factors

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9. Gross proceeds from sales over the last three years and production and sales data.
10. Present situation of the business and its prospects.
11. Bond issue prospectuses must quote permission to issue and describe procedure for issue, sales conditions, and terms and purpose of the issue.
12. The corporation's places of business and branches.

The Listing Committee of the stock exchange, which is composed of banking specialists and representatives of industry, check the adequacy and completeness of these documents and of the draft prospectus and additional statements. However, the committee neither investigate nor take responsibility for the correctness of the information, which rests with the bank and the issuer concerned. After acceptance, the prospectus must be published by the issuer in the Federal Gazette and in the stock exchange gazette, and often in at least one newspaper. Bonus (stock) issues by quoted corporations are automatically accepted for listing.

The stock exchange regulations do not mention auditors or auditing since an audit is compulsory for every AG corporation, and the contents of the audit report are stipulated by law. The opinion paragraph of the auditors' report is therefore shown in the prospectus.

## Other Types of Finance

Export finance is provided by banks or, if long term, by specialist companies sponsored by groups of banks, or by the government; export credit insurance is available from a government agency and specialist private insurance companies. Equipment leasing is becoming increasingly popular, but factoring to a much lesser extent. Leasing may or may not include an option to purchase. Because tax rules are applied stringently, a tax adviser should always be consulted before the conclusion of a leasing contract, as any later amendment may not be recognised for tax purposes. Long-term credits are available to AG corporations by the issue of quoted and unquoted debentures, and to any enterprise from banks against security, including mortgages. Even suppliers may provide finance, as for example by way of three-month bills for the acquisition of machinery and equipment, although bank guarantees may be required.

Bonds or debentures are normally secured by a first priority charge entered in the official land register. Only large AG corporations of the highest repute can issue bonds with a 'negative clause,' which means that land owned by such corporations is unencumbered and is to remain so, or that they will maintain certain balance sheet ratios. In practice, therefore, the vast majority of bonds or debentures are secured.

Due to the restrictions of insurance law, loan capital can be provided by insurance companies and pension funds only if highly secured. Bank guarantees may be accepted by private lenders as an alternative form of security.

## **CONTROLS OVER FOREIGN EXCHANGE**

### **Currency**

The monetary unit is the Deutsche Mark (DM), divided into 100 Pfennigs. The Deutsche Mark has been for many years a strong currency and is convertible into other currencies without restriction.

Denominations in circulation are:

*Notes* — DM 5, 10, 20, 50, 100, 500, and 1,000

*Coins* — 1, 2, 5, 10, and 50 Pfennigs and DM 1, 2, and 5.

### **Exchange Markets and Practices**

Exchange business is concentrated in Frankfurt and other financial centres, and is operated by banks authorised by the Deutsche Bundesbank. Exchange rates, spot and forward, are published daily.

The Bundesbank, although not controlled by the Federal Government, has power to regulate the German money and capital markets through discount rates, setting of minimum bank reserve requirements, open-market operations, and the publication of guidelines to be followed by other banks.

### **German Exchange Control Regulations**

There are no restrictions on investment, inward or outward. Repatriation of capital, dividends, interest, licence fees, and royalties can be effected without limitation through any bank. Foreign nationals are free to buy and sell securities, land or any other form of property. Apart from limitations in the supply of money or interest rate move-

# Investment Factors

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ments that may be affected by Bundesbank directives, there are no restrictions on borrowing locally by either German or foreign-owned enterprises.

Exports, imports, services rendered to and received from foreign countries, and payments and capital transactions across the border are regulated by the Foreign Trade Law. This law provides for the freedom of foreign trade, but specifies the powers of the government and of the Bundesbank to impose restrictions in an emergency to safeguard the German economy or to comply with international obligations. It also defines the foreign exchange transactions to be reported to the authorities.

All resident enterprises must report their monetary transactions with nonresidents, including those of a capital nature, to the Deutsche Bundesbank through its regional agencies, the *Landeszentralbanken*. This reporting does not imply any restriction, but is required for the compilation of statistics and to enable controls to be introduced if necessary. Penalties for noncompliance can be quite severe; for instance, a fine of DM 50,000 may be charged in a case of wilful default. Reports must be made on a series of 'Z' forms, or for capital investments (inward and outward) on 'K' forms, available from the banks. There are various exclusions by type of transaction and for immaterial amounts, but broadly these forms cover all cash transactions, capital investments, foreign debtors and creditors, and overdue or advance payments for exports. Apart from these reporting requirements, there are no special rules regarding either capital movements or the settlement of import or export transactions, and any convertible currency may be used for foreign trade purposes.

A foreign investor must also consider the exchange controls in his own country. Although German rules may allow currencies to be freely transferred, the exchange control authorities of an investor's own country may take a different view.

## ADDRESSES OF STATE DEVELOPMENT AGENCIES

State ( <i>Land</i> )	Addresses
Baden-Württemberg	Wirtschaftsminister des Landes Baden-Württemberg für Fragen der Wirtschaftsförderung Theodor Heuss Str. 4, 7000 Stuttgart 1.
Bavaria ( <i>Bayern</i> )	Referat für Industriestandortberatung Bayern Staatsministerium für Wirtschaft und Verkehr Prinzregentenstr. 28, 8 Munich 22. Tel: (0811) 2161
Bremen	Referat für Gewerbe-und Industrieansiedlung beim Senator für Wirtschaft und Aussenhandel Bahnhofplatz 29, 2800 Bremen 1. Tel: (0421) 3612275
Hamburg	Behörde für Wirtschaft und Verkehr Wirtschaftsberatungsdienst Alter Steinweg 4, 2 Hamburg 11. Tel: (0411) 34912436 – Telex 0211100
Hessen	Hessische Landesentwicklungs- und Treuhandgesellschaft mbH Bahnhofstrasse 55-57, 62 Wiesbaden. Tel: (06121) 3411
Lower Saxony ( <i>Niedersachsen</i> )	Regierungspräsident Am Sande 1, 216 Stade. Tel: (04141) 141 – Telex 218123
North Rhine-Westphalia ( <i>Nordrhein-Westfalen</i> )	Gesellschaft für Wirtschaftsförderung in Nordrhein-Westfalen mbH Königsallee 100, 4 Düsseldorf. Tel: (0211) 370529
Rhineland-Palatinate ( <i>Rheinland-Pfalz</i> )	Rheinland-Pfälzische Gesellschaft für Wirtschaftsförderung mbH Schillerplatz 7, 65 Mainz. Tel: (06131) 27358
Saarland	Aktionsgemeinschaft für Wirtschaftsentwicklung im Raum Saarbrücken und St. Ingbert GmbH Schlossplatz 6, 66 Saarbrücken. Tel: (0681) 54995
Schleswig-Holstein	Wirtschaftsförderungsgesellschaft Schleswig-Holstein mbH Lorenzendam 21, 23 Kiel. Tel: (0431) 47195 – Telex 0292629



## CHAPTER III Trading in Germany

- FOREIGN TRADE
- MARKETING PRACTICES
- PATENTS, TRADEMARKS AND COPYRIGHTS
- GENERAL REGULATION OF BUSINESS

### FOREIGN TRADE

Germany's efforts to control inflation have been more successful than those of some of its neighbours. The Federal Republic may well be a potential market for a foreign company's exports, and this is usually such a company's initial reason for contemplating operations in Germany. In addition, the country's favourable location near other highly populated markets and its good transportation services work in its favour.

The following pages therefore deal with the import and distribution of goods and associated marketing and general business practices. Where related problems are described in other chapters, cross-references are given: for example, the setting up of a branch or a subsidiary in Germany is dealt with in Chapter 6, and special points concerning West Berlin are described in Chapter 9.

#### Licences and Controls

Imports and exports are usually free of restriction, except for certain obligations under international agreements (for example, agricultural products subject to EEC rules) and specific licencing requirements concerning the import of cheap textiles and trade in goods listed in the Import and Export Lists, which are appendices to the Foreign Trade Law and Regulations (for example, armaments and other strategic or technical products). Trade with communist countries is subject to special licencing and reporting requirements. Goods covered by licence must be cleared within the validity period of the licence – normally 6 months, with a further 6 months for payment – although this can usually be extended on application before date of expiration. A new firm can normally obtain an initial share where quota arrangements exist. Licences are issued by the Bundesamt für Gewerbliche Wirtschaft, Frankfurter Str. 29, 6236 Eschborn/Ts.

As in most countries, there are health and safety rules concerning importation of foodstuffs, drugs and medicines, narcotics, animals, and plants. Information concerning these and the procedures to be followed can be obtained from local chambers of commerce.

# Trading in Germany

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Many regulations concern containers and wrapping. If any German words appear on containers, the country of origin must be shown; prices, sizes and descriptions of contents must be marked on goods for retail sale; the raw material content of textile goods must be disclosed; and there are special rules regarding foods. Certain plant and machinery must conform with safety and technical regulations.

## Customs Duties

Duties on imports, usually *ad valorem*, are levied in accordance with the common external tariff of the EEC. The 'Brussels nomenclature' is used to classify merchandise. All imports into the Federal Republic from other EEC countries are exempt from duties (but not from the import turnover tax described later) if the goods concerned either originated within the EEC or were subject to customs import duty upon entry. Preferential rates apply to imports from certain associated states. The value of imports for duty purposes is usually the c.i.f. invoice price (before taxes and duties); however, if this is artificially low, for example on a sale to a branch or a subsidiary, the value is raised to the price that the goods would fetch on an 'arm's-length' sale in the open market. Most raw materials enter Germany, as part of the Common Market, duty-free or at a rate seldom in excess of 3%. Rates for semi-finished goods range from 4% to 12%, and for finished products from 6% to 24%. Examples of specific rates are: commercial vehicles, 22%; organic chemicals, up to 18%; plastics, 16% - 18%; and diesel engines, 14%. The late EEC joiners, Denmark, Ireland, and the United Kingdom, will complete the adjustment to EEC rules by 1st July 1977 or, for horticultural products, 1st January 1978. Certain agricultural goods and foodstuffs are at present subject to compensatory levies or premiums instead of import duties, in accordance with the EEC Common Agricultural Policy. Agricultural product surpluses may attract export subsidies financed by the European Agricultural Guidance & Guarantee Fund (FEOGA).

No export duties are levied, although customer countries outside the EEC may impose their own import duties.

Noncommercial samples marked to prevent resale may be imported duty-free under an international convention, although this concession does not extend to alcohol, coffee, tea, or tobacco. Advertising material or commercial samples may be imported on provision to the customs authorities of deposits (returnable), or the production of guarantees by an approved body such as a chamber of commerce in the exporting country and the use of an international customs clearance document known as an ECS Carnet. Exhibition materials or goods temporarily

imported — for trade fairs, for example — can be dealt with similarly by using an ATA Carnet. Simplified customs procedures also apply to goods carried in vehicles approved under the International Road Transport Convention and accompanied by TIR Carnets.

The combined population of the EEC countries is over 250 million, and this populous bloc has negotiated preferential trade agreements with Greece and Turkey, the EFTA countries (Austria, Finland, Iceland, Norway, Portugal, Sweden, and Switzerland), Spain, Yugoslavia, several Mediterranean states, and under the 'Lomé Agreement,' with 46 developing African, Caribbean, and Pacific countries (mostly former British and French dependencies). Exports from the Federal Republic can thus reach a very large market duty-free or on preferential terms, and imports also be received on similar terms from EEC and associated countries. This is an important factor to be considered in any decision involving setting up a manufacturing unit in Germany.

Since customs duties may be of prime importance to foreign enterprises, and as regulations are complex, it is recommended that professional assistance be secured in particular areas of concern to prospective investors, especially to those outside the EEC arrangements.

## **Other Duties and Taxes**

Imports into Germany, whether from EEC countries or not, are liable to an import turnover tax at the same rates as the domestic value added tax (see page 148). This tax is levied on the total cost, including transportation and any duty imposed. A foreign supplier will not be liable for the tax if his goods pass to his customer before the customs barrier (for example, on c.i.f. port-of-entry terms).

Beer, wine, tobacco, champagne, brandy, vinegar, coffee, tea, sugar, salt, matches, electric light bulbs, and mineral and fuel oil products, whether produced in the Federal Republic or imported, are subject to excise duties.

Exported goods qualify for refunds of all value added tax or import taxes and excise duties paid in Germany.

## **Documentation**

No documents other than those normally used in international trade need be provided, except that import or export 'declarations' are required for statistical purposes where licences are not needed. Common Market certificates of origin may be required, however, to enable importers in other EEC countries to purchase German goods duty-free and

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vice versa. Certificates are issued for goods originating in the Federal Republic or which have undergone substantial processing there, and for other goods for which Common Market customs formalities have been completed and external duties and levies paid.

'T' forms are used for movement within the EEC area to provide evidence of origin and to act as international transit documents. Modifications of these forms, called 'movement certificates,' only provide evidence of origin for claiming preferential customs rates.

## Free Ports and Transit Arrangements

Free port areas at Hamburg, Cuxhaven, Bremen, Bremerhaven, Emden, and Kiel may be used for warehousing, processing, assembling, packaging, or reshipment of goods in international trade. Also, merchandise imported may be stored in a so-called 'duty-delaying warehouse' (*Zollaufschublager*), where, by making a deposit, payment of duty is delayed until such time as the merchandise is taken out of storage. Imported goods for later reexport, or with destination unknown at time of importation, may be stored in a public or private bonded warehouse. The approval of such a warehouse by the main customs office is dependent on the reliability of the applicant concerned, who must keep proper books. Goods may not be stored in such warehouses for longer than five years.

## MARKETING PRACTICES

### Advertising and Promotion

Newspaper, especially magazine, advertising is used for sales promotions. Magazines have a wider coverage, as newspapers have mainly city or regional, rather than national, circulation. Advertising on commercial television is important for about 80% of homes are reached by the three available networks. Other methods for sales promotion include direct mail campaigns, outdoor posters and signs, and advertisements on radio and cinema programmes. Many advertising and market research agencies, including several international firms, make advertising a highly complex industry in Germany. It is advisable, however, to engage a local advertising agency because of the legal controls operating in the Federal Republic. Directories of agencies and media are available, and local chambers of commerce can often provide useful information.

There are several important trade fairs, the majority specialised. The Hanover trade fair each spring is the largest and best known, but there are major fairs also in Frankfurt, Munich, Berlin, Cologne, Hamburg,



Nuremberg, and Düsseldorf. Exhibiting costs are high, but fairs are influential in Germany and should not be ignored by firms planning to sell in the German market.

## **Selling and Distribution Methods**

The usual method of initiating sales in the highly competitive German market is through a commercial agent, and many foreign firms as well as domestic manufacturers have done considerable business in this way. However, because of the country's history, the existence of many regional centres makes it almost impossible for one agent to cover the whole of the Federal Republic. Most agencies are small and deal only with clients in the state in which they are located, although in recent years countrywide grouping has appeared in some trades. Information concerning agents can be obtained from the Federation of German Trade Agents and Brokers' Associations (*Centralvereinigung Deutsche Handelsvertreter und Handelsmakler Verbände – CDH*) at Geleniusstrasse 1, 5000 Köln (Cologne). Foreign export agents who process enquiries from German importers are not popular.

A trade agent (*Handelsvertreter*) is usually an independent individual or firm, authorised to conclude contracts in the name of and on behalf of his principal. There are two types of trade agent: an *Abschlussagent*, who may conclude transactions that do not require ratification by the principal to make them binding; and a *Vermittlungsagent*, who must always obtain his principal's consent. Most agents represent several manufacturers at the same time.

An independent dealer (*Eigenhandler*) purchases, stocks, and sells merchandise in his own name and for his own account, often in accordance with an exclusive distribution agreement. In some circumstances, however (if, for instance, he was obliged to name his customers to the original seller), he has compensation rights on termination of his agreement, just like the trade agent.

These distinctions are important to a foreign principal from any country with which the Federal Republic has a double-taxation agreement. Such a principal should always retain the completed contracts in his own country in order to avoid the risk that he is deemed to have set up a 'permanent establishment' in the Federal Republic, with the disadvantages relating to branches (page 127). He should also furnish his German agent or distributor with a written power of attorney clearly defining the latter's powers and duties.

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In some trades, it is customary to sell exclusively to wholesalers and not directly to retailers. In these cases, wholesalers could refuse to buy from a supplier suspected of selling to retailers. Despite this, many foreign manufacturers of consumer goods deal directly with large retail chains and department stores, some of which have established buying offices in other countries. Other methods of trading with Germany are joint ventures, licensing, or reciprocal trading agreements.

The appointment of agents or distributors would not normally contravene EEC law against agreements that are likely to prevent, restrict, or distort competition within the Common Market, but businessmen must pay heed to this law (see page 38). Contracts with agents need not be in writing, although it is advisable that they always be so. Specialist legal advice is recommended on this point, for German commercial law contains elaborate provisions protecting agents, and it is unlikely that a German agent will enter into an agreement governed by the law of another country. Under German law, on termination of an agreement (except for misconduct or reasonable cause on the part of the agent), the agent has the right to compensation for his work in benefiting his principal's business. Maximum compensation is a year's commission, based on the average earned during the period of the agency or its last five years. If an agent has been appointed to deal with a defined area, he is entitled to the commissions on all sales made there, regardless of whether such sales resulted from his own efforts. Commission is due, at negotiable rates, on all contracts made during the period of the agency's activity, even though by agreement part of the commission is at times withheld until customers have paid. A minimum of three months' notice, ending on a calendar quarter, must be given upon termination of an agency agreement in effect for more than three years.

As an alternative to the use of a German agent or distributor, a foreign company may decide to employ its own salesmen. The formalities to be observed if foreigners are so employed are described in Chapter 4. Some companies then establish a stock holding point in the Federal Republic to facilitate distribution there or in neighbouring areas. Other companies may set up a fully staffed branch or subsidiary to distribute or manufacture in Germany. The customs duty implications of such actions are described earlier in this chapter, and the effect of German commercial and tax laws is described in Chapters 6 and 8.

Correspondence and trade literature should be in German, and documents for the ultimate consumer must be in that language. Literature should preferably be checked by a professionally qualified German, as language pitfalls for foreigners abound. It may even be necessary to rename a product and redesign all packaging and promotional materials.

Two examples serve to illustrate the problem: the word 'mist' in English, popular with advertisers of beauty-spray products, means 'manure' in German, and 'gift' is the German word for 'poison.' Metric measurements and European Continental sizes should be given. Prices for imported goods should always be quoted c.i.f. the German port or border, showing if possible the customs duties and import taxes applicable. If this is not possible, at least the Brussels Nomenclature customs class should be stated.

After-sales service is very important to the German market, which is accustomed to high quality products and efficient backup facilities.

## Trade Credit Conditions

Credit terms vary and are normally agreed upon between suppliers and customers, depending on the type of trade or industry concerned. Importers usually expect and receive credit terms, which are normally thirty days from invoice date, with cash discounts being given for payment within ten days.

Sales transactions are secured by retention of title (*Eigentumsvorbehalt*) until full payment has been received. An extended retention of title (*erweiterter Eigentumsvorbehalt*) covers a claim against a subsequent buyer if the goods are resold, when the respective accounts receivable are automatically assigned to the first seller. Other debts may be secured by a chattel mortgage (*Sicherungsübereignung*) on goods held by the debtor, even if their nature is changed by manufacturing process, or by the assignment of accounts receivable or contractual claims (*Sicherungsabtretung*).

Investigation agencies and banks may be requested to give references regarding potential customers, and information in the Commercial Register can be obtained upon request. It is usual for businessmen to exchange bank references when entering into negotiations, and no one should be offended by a request for such a reference. The larger investigation agencies have debt recovery services, and solicitors can also be used for the collection of old debts. Lawyers, however, are less involved in business contracts than they are in North America.

## PATENTS, TRADEMARKS AND COPYRIGHTS

A foreign national may freely acquire these and similar rights. The Federal Republic is a member of the Paris Convention for the Protection of Industrial Property, the Madrid Agreement on the International

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Registration of Trademarks, and the Berne Convention (the Copyright Union). Patent applications must be filed with the Federal patent office, and trademarks may be entered in the trademark register at the same office (Deutsches Patentamt, 12 Zweibrückenstrasse, 8000 München (Munich) 2). It is usual, but not compulsory, for a patent lawyer to handle such matters.

## Patents

Patents are granted for eighteen years from date of application, subject to payment of annual renewal fees, which increase from minimal amounts to DM 1,700 in the eighteenth year. The invention or process concerned must not have received sufficient publicity in Germany for it to have been put into use there before the application was made. Because of the Paris Convention, however, a patent application in any signatory country (most industrialised countries in the world) establishes a one-year right of priority in the Federal Republic. Thus, an inventor has one year from his application for a patent in another country to take out a patent in Germany, even though during that year someone else in Germany may have tried to establish a patent for the same invention. The grant of a patent is conditional on a prior examination regarding its originality. A 'Patent of Addition' (*Zusatzpatent*) may be granted for the unexpired portion of the related principal patent. Compulsory licencing may be required if a patent is not worked within three years of issue (with some exceptions). Patents can cover foods, pharmaceuticals, and chemicals; and manufacturers' model products and tools can be protected by a modified form of patent called a utility model or petty patent (*Gebrauchsmuster*), which has a 3-year renewable life. Temporary protection is available for exhibits at trade fairs.

## Trademarks

Trademarks can be registered for periods of ten years and may be renewed thereafter; the first applicant is entitled to the exclusive use of the mark. Fees are small. A mark must be used within five years of registration, or it will no longer be reserved.

Competition between member-countries of the EEC may not be restricted by national patent or trademark laws.

## Copyrights

Copyrights give protection for the life of the originator plus fifty years. Copyright works should show the name of the author, date of first publication, and the letter 'C' in a circle.

## Trade Names

The trade name of a new enterprise must be distinct from other registered firm names to avoid confusion. For this purpose, the local chamber of commerce should be requested to issue a certificate clearing any proposed name for entry in the Commercial Register.

## GENERAL REGULATION OF BUSINESS

### Monopolies and Restrictive Practices

The antitrust or cartel law provides for the prohibition of cartels and monopolies that tend to restrict competition. Under certain limited conditions, agreements covering uniform general business conditions, uniform rebates connected with the delivery of goods, exports, and imports, and the rationalisation of production and sale can be permitted, but agreements fixing prices are never allowed. Practices so permitted, and the general observance of the law, are controlled by the Federal Cartel Agency (*Bundeskartellamt*), at Mehringdamm 129, 1000 Berlin 61.

The Fair Trade Law against unfair practices is strict. Definitions of the fair practices of a reasonable and honest businessman are constantly being improved, and in this area there is much case law. The law protects consumers against deceptive advertising, false representation, and unfair acts against competitors. For instance, the hiring of a competitor's employee for such unethical purposes as acquiring business secrets is considered a violation of the law (unless the employee has given proper notice in accordance with his employment contract). The same is true for cutthroat pricing policies designed to break competitors, although in general there are no restrictions on the pricing of goods by individual sellers, unless the actions of a market-leader may be construed as misuse of a dominant power and thus prohibited. Trading stamp schemes and presentation of valuable gifts to buyers are not permitted. The observance of these laws is also controlled by the Federal Cartel Agency, which levies substantial fines where breaches of the law are found or abuse of a market-dominating position is established. Matters of dispute among competitors are settled by arbitration boards of the local chambers of commerce.

EEC rules prohibit restraint of trade between member states by the distortion of competition, and enable cross-frontier monopolies to be challenged (rules summarised on pages 38-40). In 1976, Germany and the USA signed an agreement for mutual action on restrictive practices affecting both countries' markets.

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**Mergers.** The Federal Cartel Agency must be notified of and is empowered to prevent any proposed merger of business entities that would bring together a 20% or more market share, 10,000 employees, or a turnover of DM 500 million, whereby a dominant position in the market is attained or strengthened.

**Intercompany Relationships.** There are special provisions, described in Chapter 6, regarding relationships between commercial entities whereby an AG corporation is controlled by another enterprise.

## Chambers of Commerce

These bodies are responsible for promoting commercial activity of all kinds. In addition, they deal with various matters which in other countries are the responsibility of government departments, such as the certification of commercial documents and the conducting of trade proficiency examinations. Membership is compulsory for all enterprises on the Commercial Register. There are over eighty chambers of commerce (*Industrie-und Handelskammer*) in the country, each situated in the main city of the region for which it is responsible.

The chambers can give much assistance to enquirers, German or foreign. A prospective foreign investor, at an early stage in his planning, should approach the chamber for the area in which he proposes to establish his business; he will be given impartial assistance and advice about the various government agencies, regional planning councils, and local bodies to be contacted as his project develops.

## Commercial Law

German law is all statutory: judges may interpret the rules by case decisions but cannot make law if the statute concerned is deficient. Commercial law is set out in the Commercial Code (*Handelsgesetzbuch*). This code deals with 'merchants' — traders, producers (but not individual craftsmen), bankers, insurers, transporters, publishers and printers, and agents of all kinds. These merchants must be registered in the Commercial Register maintained at the local court (see page 15). Any others who carry on business as commercial enterprises and who thus register are also deemed to be merchants and so are subject to the Commercial Code. Merchants must keep prescribed books, as indicated in Chapter 7. On the whole, laws are weighted in favour of consumers.

## Insurance Practices

The insurance of third-party risks, for example employers' liability insurance or injury by motor vehicles, is obligatory. Third-party automobile insurance in excess of the legal minimum is usually carried. In

the south German states, fire damage of buildings is also compulsorily insured by state agencies. Types of social insurance are described in Chapter 4. It is both possible and customary in Germany to insure against all the risks met in other countries. The insurance industry is governed by a special law, and insurance companies are supervised by a federal government agency that approves the terms and conditions of any insurance offered to the public. As these terms and conditions are extremely intricate, a competent insurance agent should be consulted. In general, certain risks (for example, war, riot, or earthquake) are excepted; but fire, storm, tempest, cash, and fidelity risks can all be insured. Technical equipment, such as automobiles, boilers, or elevators, is periodically inspected by a special technical supervision agency.

Premiums for insurance contracts covering real property are generally adjusted for price increases by indexation.

## **Authorised Signatories**

The position of two types of employee of a German enterprise should be noted. These are the *Prokuristen* and the *Handlungsbevollmächtigte*; both are subordinate to the managers whose powers and duties are outlined in Chapter 6.

*Prokuristen* are managing employees who are authorised to act for the management of the enterprise in all day-to-day business matters normally undertaken. A *Prokurist's* authority must be recorded in the Commercial Register and may be extended to enable him to sell or mortgage real estate. He is usually limited to act jointly with a manager or with another officer of the enterprise; however, he can be authorised to act alone, and his transactions with third parties are binding on the company. When signing letters on behalf of the enterprise he must add before his signature the letters 'ppa.' *Prokuristen* are appointed by the managers of their companies or sometimes by the shareholders.

The authority of a *Handlungsbevollmächtigte* is more limited than that of a *Prokurist* and is usually restricted to routine operations excluding signing of bills of exchange, granting of loans, or appearing for the company in a law court. The *Handlungsbevollmächtigte* is not permitted to sign business letters on his own, and registration is not required.

## **Environmental and Health Considerations**

Much attention is given to the maintenance of the environment and the improvement of living and working conditions. There are stringent laws

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concerning water and air pollution; and on the principle that 'the polluter pays,' newly-established enterprises may find themselves faced with demands from local authorities for modifications of plant or installation of purification equipment, or they may even be refused permission to build factories on their chosen sites. Industrial consultants experienced in these matters are available, and early discussions with the state development authorities or the local chamber of commerce are advisable. Buyers of commercial products are increasingly protected against poor-quality goods.

## EEC Rules on Fair Competition

Many of the European Common Market's rules about fair competition are extensions of German law on that subject; but as Articles 85 and 86 of the Treaty of Rome, which established the European Common Market, are of considerable importance to manufacturing and trading organisations, they are described here in some detail.

One object of the EEC is to establish a single market within which all organisations can offer their goods or services to all consumers in the Common Market without restrictions of any kind.

The most obvious restrictions were national customs duties, which have now largely been abolished. Other restrictions slowly being tackled include discriminatory import procedures, bars on the free movement of services, state monopolies, state aids to industry, and differences in legislation. These are matters that are dealt with at government level; Articles 85 and 86 are designed to prevent individual business organisations from creating further barriers. In principle, any acts that disrupt the economic conditions of the Common Market are prohibited, unless the effect is insignificant or is advantageous from an economic or competitive point of view. Examples of prohibited practices are price fixing, market sharing, production restrictions, or discriminatory terms of supply.

Article 85 is concerned with agreements and concerted practices between undertakings, and Article 86 with the abuse of dominant positions. They apply whenever there is a possibility that consumers in one area may be treated differently from those in other areas, but they do not bar cooperation where this will favour competition. It should be noted that the rules govern not only intra-Common Market agreements but also agreements by enterprises in the Common Market with bodies in other countries if they affect trade within the EEC. There are heavy penalties for noncompliance.



**Article 85.** Paragraph 1 prohibits 'all agreements between undertakings, decisions, and concerted practices which may affect trade between member states and which have as their object or effect the restriction of competition within the Common Market.' 'Agreements' are legally enforceable contracts, but 'concerted practices' could be operated on a much less formal basis. Paragraph 2 states that 'any agreements or decisions prohibited by this article shall be automatically void' (although in practice they are not void while the possibility exists of obtaining exemption). Once an agreement has been reported to the Commission, exemption may be granted in accordance with paragraph 3.

It is essential that the enterprises themselves should apply for exemption. A request for a 'negative clearance' should be made to the Commission accompanied by a request for 'exemption' under paragraph 3. Once an agreement has been registered, it is provisionally valid until the Commission makes its decision.

Application must be made to the Commission in Brussels on Form AB in ten copies. Negative clearance will be granted if the Commission is satisfied that there are no grounds under Article 85 (1) for them to take action. If, however, the facts suggest that action may be required, then the Commission will consider the possibility of granting an exemption. Questions of law may be taken to the European Court of Justice in Luxembourg.

Matters taken into consideration when deciding whether an agreement (for example, an exclusive sales agreement) limits competition include:

1. The position and importance of the parties and the nature of the product.
2. Whether the agreement is isolated or one of a series.
3. The severity of the conditions and whether some absolute territorial protection is given or, conversely, whether parallel trading or reexport is allowed.
4. The benefits to be obtained from cooperation between enterprises, such as improved production or distribution, or technical or economic progress.

An agreement between a parent company and its subsidiary would not be prohibited, as the latter is not an independent undertaking.

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There are numerous exemptions from the provisions of Article 85 (see table on page 42). This table is only a summary of the exemptions; it is important to obtain legal advice when agreements are being drawn up. In addition to the various broad classes shown in the table, many individual agreements have been exempted from the requirements of Article 85 following notification. These rules appear complex, but they are directed toward fair competition throughout the Common Market and have now been in operation for some years.

**Article 86.** This article prohibits abuses by undertakings with a dominant position within the Common Market that may affect trade between member states. For the article to apply, an undertaking must be able to prevent effective competition within an important part of the relevant market; for example, by the creation of a cross-frontier monopoly.

**Article 36.** This article, in the section of the Treaty of Rome dealing with the elimination of quantitative restrictions, provides that industrial and commercial property rights may not be exercised to restrict trade, as for example, a patent licence which must not enable the licensee to prevent imports from another member state or to use different pricing policies in different member countries.

## Information Required on Business Documents

The letters of a German organisation must show its name and address (the principal office registered as the legal seat of the enterprise in the Commercial Register), its legal form (for example, corporation or partnership), the name of the Commercial Register in which it is recorded and its registration number, the names of the members of its management board, and if applicable, the chairman of its supervisory board. Invoices, receipts, or delivery notes are not included in the term 'letters.' It is customary to show the name and code number of the organisation's bank account on invoices.

Sufficient information must be shown on invoices to enable value-added tax to be computed and properly accounted for.

## Real Estate

Ownership of land and buildings, and the existence of mortgages or charges thereon, are evidenced by entries in a real estate title register or

land register (*Grundbuch*) for each area, kept at the local court. Transfers of title, and the creation and settlement of charges, require attestation by a notary, and only become legal upon registration in the *Grundbuch*. The buyer, not the seller, usually pays the property agents' fees on a real estate transaction. The leasing of real property by paying a capital sum at the outset of a fixed term, instead of rent, is not recognised.

Practically all sites have water, gas, and electricity and are served by good roads; many also have rail or canal connections. Large consumers can negotiate special rates for public utilities. The use of natural gas (domestic, Dutch, and Russian) is growing.

Building permits are required for all new buildings, including houses, and the use of specialist consultants may often be advisable, as there are many regulations concerning the property market that must be observed. Medium and small premises are available in most parts of Germany; but in normal times, at least, large premises for rent or sale may be in short supply. Typical monthly office rents in Frankfurt-on-Main in the summer of 1975 were DM 12 to DM 20 per square metre (about 10 sq. ft.), the latter for luxury accommodation.

## **International Trade Organisation Membership**

The Federal Republic is a strong supporter of the European Common Market, the EEC, and its associated bodies, the European Coal and Steel Community and the European Atomic Energy Community. The six original members — France, Germany, Italy, and the three Benelux countries — were joined on 1st January 1973 by Denmark, Ireland, and the United Kingdom. The EEC is more than a customs union: the founding Treaty of Rome calls for the free movement of peoples, services, and capital; common agricultural and transport policies; the establishment of regional aid and social funds; and measures to coordinate commercial and economic policies. The EEC's population of 250 million comprises one of the world's most important integrated markets for raw materials, industrial equipment, and consumer goods.

Germany is also a member of the Organisation for Economic Cooperation and Development and is a party to GATT.

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Summary of Agreements, Decisions and Concerted Practices  
Not Invalidated by Article 85 of the Treaty of Rome  
Affecting All the Countries of the European Common Market

## **AGREEMENTS WHICH NEED NOT BE NOTIFIED**

These are described in Regulation 17 of 1962 amended by Regulation 2822 of 1971.

1. Those where the parties are all from one member state of the EEC and the terms do not relate to trade with other member states.
2. Those where only two parties are involved and the agreements are limited to:
  - (a) the fixing of selling prices to third parties
  - (b) restrictions on the rights of users of patents, 'know-how,' and the like.
3. Those which have as their sole object:
  - (a) the development of standards
  - (b) joint research and development
  - (c) specialisation in manufacture, where not more than 15% of the trade in the relevant product in a substantial part of the Common Market is concerned and where the combined annual turnover of the parties does not exceed 200 million U.A. (see note next page).

## **AGREEMENTS OUTSIDE THE SCOPE OF ARTICLE 85**

These are agreements not restricting competition or which, if restrictive, are immaterial.

1. Official Journal of 1962, December 24th.

Those agreements which, even if exclusive, are between a principal and a commercial agent by which the agent merely negotiates on behalf of a particular supplier (in his own name or otherwise) without assuming financial responsibility for the goods concerned.

2. Official Journal of 1970, June 2nd.

Those agreements not affecting more than 5% of trade in the relevant products in the Common Market area concerned, and where the parties have combined annual turnover of not more than 15 million U.A. (industrial enterprises) or 20 million U.A. (other bodies).

3. Official Journal of 1968, July 29th.

Cooperation agreements whose sole object is, for example:

- (a) exchange of technical or market information
- (b) joint activities such as advertising, debt collecting, or accounting
- (c) shared production, storage, or transport facilities
- (d) shared execution of orders, or shared after-sales service, where the parties are not themselves in competition.

## EXEMPT AGREEMENTS

These are covered by 'block exemptions' already granted.

1. Regulation 2779 of 1972.

Those agreements for specialisation of production where not more than 10% of trade in the relevant products in any member state is concerned and where the combined annual turnover of the parties does not exceed 150 million U.A.

2. Regulation 67 of 1967 amended by Regulation 2591 of 1972.

Those agreements between not more than two parties in which:

- (a) one undertakes to supply the other exclusively with certain products for resale in certain areas or
- (b) one undertakes to buy only from the other for the purpose of resale
- (c) both purchase and sale arrangements as above are dealt with.

(Note: A supplier cannot forbid a distributor to sell to a customer in another area who comes to him with an order.)

3. The Commission has been authorised to grant block exemptions for patent licence, and related agreements, but has not yet issued regulations.

*Note:* U.A. or 'Units of Account' were linked to gold, and until the 1971 currency alignments were equivalent to one US dollar. They are now based on a group of European currencies, and in March 1976 were worth about DM 2.84, £0.61 or US \$1.12.



## CHAPTER IV Labour Conditions

- THE LABOUR FORCE
- POSITION OF FOREIGN NATIONALS
- TERMS AND CONDITIONS OF EMPLOYMENT

- SOCIAL SECURITY AND FRINGE BENEFITS
- LABOUR-MANAGEMENT RELATIONS

### THE LABOUR FORCE

#### Availability

The German labour force, including the self-employed, numbers about 26 million, of which about one-third are women. Full employment is usual in normal times, figures showing fewer unemployed than job vacancies. No significant reserve of married women is available.

The world economic situation changed the picture however, and in 1976, unemployment was around one million, about 4% of the labour force. Unemployment varies from district to district, which is one reason for the investment incentives described in Chapter 2. The available labour is usually well-educated and trained. The professional school system is highly developed; there are various grades of technical schools, and special evening courses are provided. Furthermore, apprentices are trained in factory, workshop or office, mainly at the business community's expense, and many large enterprises maintain excellent training centres. Scarcity of labour for many years has resulted in great emphasis on science, research and development, and technological innovation.

#### Recruitment

Private employment agencies, with the exception of temporary staff bureaus, are not permitted in Germany. Their functions are performed by government labour offices (*Arbeitsämter*), which are regional branches of the *Bundesanstalt für Arbeit*, a government agency. These labour offices, whose services are free, are an important source not only of full-time factory and office workers, but also of part-time workers, especially married women. A section of the *Bundesanstalt für Arbeit*, called the Central Placement Office (*Zentralstelle für Arbeitsvermittlung*), specialises in the recruitment of executive, managerial, technical, and professional staff and, when allowed, in the placement of foreigners. In practice, executives are not usually recruited through the government labour offices, but through newspaper advertisements, especially on weekends. Because of the normally tight manpower situation, such advertisements are used to recruit even junior office staff. Often employers engage management consultants to obtain managerial staff. Employers must reserve one job in every sixteen for seriously disabled workers.

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Newly established firms, however, may have difficulty in recruiting staff because service contracts often contain provisions barring employees from joining competitor firms within a certain time period. For this reason, some foreign companies planning to establish themselves in Germany, and which in the past have acted through selling agents, have found it worthwhile to take over the agents, not only for their commercial contacts but to obtain sales executives and employees.

## POSITION OF FOREIGN NATIONALS

In early 1976, there were about 2.1 million foreign workers in Germany. Since 1973, the inflow of nationals from other than EEC countries has practically ceased as the work permits they require are no longer issued.

The regulations concerning documents required and social security vary depending on whether the incoming foreign national is from another EEC country or elsewhere and whether there is a social security convention with the country concerned.

### Documents Required

The rules are of importance to every businessman entering the Federal Republic or West Berlin. Documents that may be required are proof of identity and residence and work permits.

A foreigner not seeking employment and staying no longer than three months, or if employed in a foreign company, two months, needs:

1. If an EEC national, a valid identity card or passport.
2. If a national of another country, a valid passport and in some cases an entry visa, known as a 'permit to stay.'

A foreigner taking a job, except temporary work for a foreign employer, or otherwise gainfully employed must have:

1. Proof of identity, as above.
2. Residence permit (*Aufenthaltserlaubnis*). This is obtained from the Aliens Authority (*Ausländerbehörde*) at the regional police office of the area in which the intended residence is located. This permit is usually valid for five years but may be renewed. The issuing of a residence permit is at the discretion of the authorities, but normally no objections are encountered.

3. Work permit (*Arbeitserlaubnis*). Nationals other than those from EEC countries require work permits. A request for employment should be submitted by the prospective employer to the local labour exchange, which will issue a preliminary work permit to enable the prospective employee to obtain an entry visa; a fixed work permit will be issued when a residence permit has been granted. Since 1973, work permits have not as a rule been issued; but if issued, they are usually for specific jobs, valid for one or two years, although renewable.

Work permits are required only by prospective employees. The work permit procedure is a control measure to regulate the German labour market; therefore, work permits are not required by directors, managers, or legal representatives of foreign companies. Expressly excluded from work permit requirements are assembly and repair technicians coming to the country following the import of equipment; students, for no longer than 2 months' work; self-employed persons, and journalists. Apprentices and trainees, however, require work permits.

Foreigners who have lived and worked in Germany for five years or more can generally obtain long-term residence and work permits. All foreigners must report their presence in the country to the Aliens Authority. In addition, a self-employed foreigner must have a certificate issued by the supervisory agency for business and trade (page 15). These formalities normally pose no difficulties, but they should not be overlooked.

## **Labour Law and Social Security**

German labour law applies equally, as a rule, to German nationals and to foreigners employed in Germany.

All employees in a German establishment of whatever nationality, and their dependents, automatically become members of the Federal Republic's social security system. The local social security office must be notified without delay when a foreigner is employed by a German enterprise.

In the case of employees from outside the EEC area, social security contributions may remain payable in the foreigner's own country despite the requirements to contribute to the German scheme (unless a reciprocal social security convention provides otherwise).

Germany has concluded social security conventions with many countries providing for reciprocal treatment for their respective nationals. These conventions are with the other EEC countries and with Austria,



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Canada, Greece, Norway, Poland, Portugal, Romania, Spain, Sweden, Switzerland, Turkey, and Yugoslavia. A convention has been signed with the United States and this is in process of ratification.

If the foreigner is from another EEC country and will probably stay in Germany less than a year, he may be allowed to remain a member of his own country's scheme, thus avoiding German contributions. Should employment in the Federal Republic continue after a year, this arrangement may be extended. The employer concerned should apply to the local social security office.

Foreigners and their employers will wish to ensure not only that long-term social security benefits such as pensions, unemployment or disability pay are preserved, but also that risks of hospitalisation and medical treatment are adequately covered.

## TERMS AND CONDITIONS OF EMPLOYMENT

### Wage Rates

Wage rates in Germany have risen in the last decade; although perhaps not as rapidly as elsewhere. This is because wage rates were already high, and also because Germany has been more successful in controlling inflation than other nations. However, German wage rates are among the highest in Western Europe. Wages vary according to occupation, skill, and locality, but the following are the published national average rates of gross pay for industrial occupations in April 1975, including overtime premiums, but excluding bonuses and other benefits:

	<b>Men Per Hour</b>	<b>Women Per Hour</b>
Skilled	DM 10.95	DM 8.07
Unskilled	8.75	7.22
Average	10.30	7.46

By mid-1976, the rates shown had probably increased by about 8½%. Office workers' pay tends to be on average one-third higher, and their salaries have risen faster than manual workers' wages in recent years. Wage agreements provide for equal pay for equal work by men and women. Prospective investors can obtain up-to-date information on pay rates from the appropriate employers' association.

Minimum wage levels are not fixed by law. Most wage rates are determined by collective bargaining, and industry-wide agreements for defined occupational groups can be declared legally binding on workers

and employers. In practice, these agreements only set minimum levels, which are often considerably exceeded by actual earnings.

Representative monthly salaries for Frankfurt office staff, illustrating current rates are:

Bookkeeper	DM 2,000 - 3,000
Private secretary (bilingual)	2,000 - 2,500
Typist	1,200 - 1,700

Various bonuses are given, as well as overtime premiums. Christmas bonuses up to DM 100, the maximum that employees may receive tax-free, are customarily given, and payments for a '13th month' are practically universal. After three years, bonuses that are regularly paid without qualification become part of the agreed-upon wages or salaries.

Industrial workers are usually paid by the hour; time rates are more common than piece-work rates or payment-by-results because of the increasing use of sophisticated machinery and equipment that makes workers' individual performances less meaningful for payment purposes. Instead, group production bonuses are more usual.

Wages are generally paid in cash, and salaries by giro transfer. Piece-work wages are often calculated fortnightly, although payment is made weekly. The first week's wages are paid on account and are roughly based on hours worked; this reduces clerical work in payroll preparation. Salaries, and other wages paid at time rates, are paid monthly. Every employee must be shown how his pay was calculated.

The effect on payroll costs of social security contributions and fringe benefits is described on page 53.

**Overtime.** Germany's economic boom provided considerable opportunities for overtime work for many years. Overtime hours are usually defined in negotiated agreements, although a minimum overtime rate of 125%, time-and-a-quarter, is established by law. Rates fixed by collective agreements usually exceed this figure, and 150% of the basic wage is normally paid for Sunday work and 200% for public holidays. Night-shift work is often paid at 135% of basic rates.

**Annual and Other Paid Leave.** Paid public holidays vary between ten and thirteen, as listed on page 64, because they are fixed by state and not by federal laws. If they happen to fall on a weekend no other days are given instead. There are legal minimum requirements for an-

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nual paid holidays or vacations (fifteen working days after six months' service, and eighteen days for employees over thirty-five); but these are invariably increased by collective agreements, and the usual rule is eighteen to twenty-six days according to seniority and occupation. The works council, described later, must agree to the general vacation plan and also reconcile particular arrangements of any individual employee in dispute with his employer. Vacation and public holiday pay is allowed at the average of the last thirteen weeks' pay, taking overtime into account, but most collective agreements provide for holiday bonuses, such as metal workers who receive vacation pay at 130% of average hourly earnings. Payments are made directly to workers by their employers, and not through social security bodies. Employees cannot normally be required to work on Sundays or legal holidays if they do not wish to do so.

Employees are entitled to paid leave for family reasons such as death of husband or wife (up to four days), moving house (one day), or marriage (two days). Women who manage a household, whether or not married, receive one day's leave each month, and additional free time is granted to women with children under fourteen.

During illness, wages or salary must be paid for six weeks and, if the employee has been on the payroll for four weeks or more, the difference between his social security sickness benefit and his average net pay must be made up by the employer for a further six weeks.

## Working Hours and Conditions

Social legislation was pioneered by Germany in the 1880s. It is therefore to be expected that labour law is detailed and comprehensive. Unlike most sectors of German law, there is no single labour code although one is currently being prepared, and labour court decisions are often necessary to deal with developing situations. In general, the terms and conditions of employment and dismissal are determined by the individual employment contract that must be concluded between each employee and his employer, and for most workers also by the collective labour agreements negotiated by their trade unions. Both individual and collective contracts are governed by general contract law, which provides that the parties may freely determine their own contractual arrangements. However, some statutes provide minimum benefits that cannot be arbitrarily disregarded by the contracting parties. These include maximum working hours, minimum working conditions, minimum vacations that must be provided and paid for, arrangements for pensions, requirements concerning apprentices, allowable absences due to illness, and dismissal conditions.

**Working Hours.** Regular working time does not generally exceed eight hours per day, but may be temporarily extended to ten hours with the agreement of the works council. Exceptions to this rule may be granted in the public interest by the trade supervisory agency. Collective bargaining agreements have gradually introduced the five-day, forty-hour week, now normal for manual workers; office workers usually have similar hours, but with a later starting hour.

Wage earners must receive half an hour for meals and recreation if their working time exceeds six hours daily.

Women and juveniles may not work between 20.00 and 06.00, although there are exceptions for establishments working more than one shift. Women may not work six weeks before and eight weeks after childbirth; they cannot be dismissed during this period, their average pay comes from funds provided by the employer and the government health insurance plan. Working hours of apprentices are restricted — they must have more free time than is required for older employees, and they must be given time off to attend elementary technical schools. School-children under fourteen may not be employed except as messengers or in similar light occupations.

The practice of flexible working hours (*gleitende Arbeitszeit*), whereby an employee may select his own working hours within ranges established by the employer, has attracted attention recently. Where this practice has been adopted, each employee's time is recorded by a control clock.

**Contracts of Employment and Severance Rules.** As soon as any person, German or foreign, is employed, his relations with his employer are governed by an employment contract. Such a contract is often inferred from the actions of the parties to it, especially manual workers employed on terms negotiated in a collective agreement, and so need not be in writing. For salaried employees, however, a written agreement is usual because any special conditions in a contract must be in writing such as the 'barring competition' condition, that is widely included, for they apply only to them. Under an employment contract, an employee is obliged to work, to be loyal to his employer, and to follow instructions; an employer is obliged to remunerate his employee, to comply with employment law, and to ensure the safety and welfare of his employee. An employment contract normally deals with hours, vacations, rates, bonuses, and special notice periods, and contains a job specification describing duties, responsibilities, and relationships. Short trial periods of employment for predetermined periods are allowed; the

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statutory maximum for a manual worker is four weeks and for a salaried employee three months. Most employers take advantage of these trial periods before offering employment contracts because of the difficulty in terminating employment later. Contracts are continued during an employee's illness or accident and for six weeks before and eight weeks after childbirth, and are suspended during military service.

In German law, there is a distinction between ordinary termination, when statutory or collectively agreed-upon notice periods must be given, and extraordinary termination involving redundancy or summary dismissal.

**Ordinary Termination.** Several laws govern the period of notice that must be given to discharge employees and the required severance payments. Employees paid on an hourly basis must be given at least two weeks' notice prior to the end of the month for which the notice is to take effect. After five or ten years' employment, a one or two-month notice respectively must be given before the end of the month of discharge. After twenty years, the notice requirement increases to three months prior to the end of a calendar quarter. The notice period for salaried employees is six weeks and is extended to three, four, five, and six months prior to the end of a calendar quarter after five, eight, ten, and twelve years' employment, respectively. Notice should preferably be in writing and should specify the grounds for termination. Payment in lieu of notice should be provided for in the employment contract. An employee wishing to leave his job must give his employer similar notice.

All discharges must be socially justified; that is, only if the conduct of the employee or pressing requirements of the business, as an unavoidable plant shutdown for instance, provide sufficient reason. Even discharges that meet these criteria may not be 'socially justified' if the employer did not consider matters of social justice in discharging a particular employee, and onus of proof in cases of dispute lies with the employer.

**Extraordinary Termination.** Dismissal without prior notice is permitted only for serious breaches of duty. Dismissal must take place within two weeks of the events causing it, and the employee may demand the reasons to be in writing. The works council must agree in all cases of dismissal, and even if the employee is to be employed elsewhere in the organisation, the works council must approve. Dismissal for reasons of illness is not admissible.

If the dismissed employee takes his case before the labour court, he is entitled to continued employment until legal proceedings are completed. He must take legal action within three weeks, however.

Discharge for redundancy in particular requires the works council's consent; the council must be informed in advance of likely redundancies and its agreement in the selection of employees for discharge obtained. If redundancy is expected the works council will require a 'social plan' to be prepared whereby workers will receive benefits varying with age and length of service. Mass discharges (10% upwards) from enterprises employing twenty or more employees are not effective unless the local labour office is notified in advance; the works council's opinion on the plan must be attached.

Unless a wage-earner aged twenty-one or more deserves immediate dismissal because of his own misconduct or on discharge refuses to accept another job offered to him, which he may be required to accept, he is entitled to receive from his employer a severance payment of one week's pay for every year of uninterrupted employment. If his dismissal was socially unjustified, but a continuance of his employment cannot be demanded of his employer for personal reasons, the court may fix as his severance payment one year's pay.

**Other Rules.** There are various laws concerning health and safety. The employment of disabled workers has already been mentioned; but, as an alternative, monthly contributions of DM 100 can be made to a central fund for each position in the disabled quota that is unfilled. Pay is guaranteed during temporary plant shutdown, as for repairs, for example, at the average for the preceding period. Employees' inventions, even if made outside working hours, may be patented and used by the employer unless they are unrelated to the employer's type of business. Compensation by the employer for such inventions must be appropriate, and there are procedures for the settlement of any disputes that might arise.

## SOCIAL SECURITY AND FRINGE BENEFITS

Social security and fringe benefits, whether mandatory or voluntary, play an important role in safeguarding social life. In addition to the mandatory social security scheme, employers must bear other social charges resulting from collective agreements. The combined costs may add as much as 60% to an employer's manual labour costs (rather less

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for salaried staff). To illustrate how these costs build up, the table on page 59, published by the employers' association of the metal-working industry, lists the various benefits and their respective costs.

## Social Security

Germany's system was the first in the world, having been introduced by an imperial decree of 1881. Its basic conception is the protection of lower-income employees, and their dependents, who must be insured against health, unemployment, and disability risks, and the provision of retirement benefits.

**Costs.** Employers and employees each pay half the social security costs; if there is any deficit in the social security funds, this is borne by the federal government out of general revenue. The employee's contributions are withheld from his pay, and the employer must file a monthly return and remit the combined contributions within five to seven days after the end of each month. Health, unemployment, and retirement benefit insurance contributions are all paid together to the general local health insurance fund office or to other qualifying health insurance funds, at the choice of the employee. The latter funds offer somewhat different benefits from those of the general local health insurance fund office.

For 1977, mandatory contributions for health insurance cease when annual earnings exceed DM 30,600. Contributions for unemployment insurance and retirement benefits are limited to maximum annual earnings of DM 40,800, so that employees earning more than this amount contribute only on DM 40,800 and receive old age benefits based on that maximum upon retirement.

The following table gives the compulsory social security rates for 1977 as percentages of gross pay up to the earnings ceilings stated above.

	Employer %	Employee %	Total %
Health insurance (average rates)	6.0	6.0	12.0
Unemployment insurance	1.5	1.5	3.0
Disability, old age, and widows' pension insurance	<u>9.0</u>	<u>9.0</u>	<u>18.0</u>
	<u>16.5</u>	<u>16.5</u>	<u>33.0</u>

Payments for social security have increased over the years. Not only have earnings and earnings ceilings risen, but so have contribution percentages. The ceilings, as a rule, are adjusted annually as are sometimes the contribution rates.

In addition to the contributory social security arrangements, employers must contribute to the industrial injuries insurance scheme to cover accident and illness arising from employment, including accidents occurring on the way to and from the place of employment. In general, all wage and salary earners are included, but not self-employed people. The cost, borne entirely by employers, varies with the degree of risk in each occupation group, with the average being about 2% of the payroll. Mining and other high-risk employment groups carry much higher insurance rates.

**Benefits.** Social security is available for the insured person and his dependents. There are qualifying contribution periods before retirement and full unemployment benefits can be paid, but health benefits and lower unemployment assistance in case of need are payable at once.

Health insurance covers medical, hospital, and similar treatment. It also provides for periodic medical examinations and allowances during illness at 80% of previous net earnings for up to 78 weeks in any three-year period. Death grants are also provided.

Unemployment insurance covers not only loss of job but also loss of hours due to short-time working. Benefit is payable for 78-312 days, depending on the period of contributions paid, averaging 68% of normal net earnings. Those not qualifying for this benefit, for whatever reason, may receive unemployment assistance from government bodies, subject to a means test, averaging 58% of net earnings. Unemployment aid never exceeds previous earnings. The unemployment insurance fund covers not only unemployment benefits but also vocational guidance and retraining schemes to reduce unemployment.

Disability and old age pensions provide medical treatment where working ability is affected, training for suitable new work in case of partial disability, social assistance, and payment of annuities in the case of invalidism or old age. The annuities are based on the average remuneration of the last three years and past contributions to the fund. Pension annuities are 'dynamic,' that is, they are related to the general level of earnings, adjusted yearly. Retirement benefits start at age 65 for men and age 60 for women, but the rules are flexible.

Children's allowances are not paid through social security funds but by the government through local labour offices. There are other benefits for totally disabled persons, farmers, and agricultural workers.



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**Voluntary Contributions.** Not every citizen is covered by the social security system. Generally, those outside the scheme, such as the self-employed, those earning above certain levels, and others, may voluntarily contribute to the social security schemes, with the exception of unemployment insurance, or make their own insurance arrangements.

## Employees' Welfare Funds and Pension Schemes

Employers customarily provide many additional benefits although these vary from employer to employer. Many firms maintain employees' welfare funds (*Unterstützungskassen*) to help employees at times of special need, such as illness, death of a close relative, or childbirth; grants are made at the discretion of the employer, and the programme is approved by the works council. Many companies also maintain pension schemes, bearing the entire cost. Under certain conditions, these welfare and pension funds are tax-exempt (page 124). Such schemes can be important in attracting new staff. Together with the social security benefits, they often provide pensions of 60% to 75% of preretirement income. Pension schemes (*Pensionskassen*) can be funded or unfunded; the former must be to separate legal entities or paid for by premiums to life insurance companies. An important law of 22nd December 1974 states minimum conditions for welfare funds and pension schemes, in particular granting rights to employees who resign, allowing their transfer to other employers; requiring periodic reviews of benefits in order to maintain their value; allowing flexibility in the retirement age, and safeguarding benefits from schemes against risks of employers' insolvency.

## Other Fringe Benefits

Bonuses and paid leave entitlements, either established by law or agreed upon through collective bargaining, have already been described. Most firms pay employees' transportation expenses between home and place of employment, as a rule, up to the tax-deductible limit. Subsidised canteen and similar facilities are widespread, and some firms also provide low-cost housing. Cars are often supplied to salaried staff, although any private benefit is taxable. Both employers and the government subsidise employees' savings schemes; these may be invested in the employing company or through banks, insurance companies, and building societies or in the stock exchange, according to the DM 624 Act (so-called because DM 624 per annum is the maximum tax-exempt savings qualifying under this act). Benefits from the Savings Bonuses and Housing Construction Bonuses Acts are also available. Profit-sharing or share option schemes are offered by many companies, but these cannot be combined with pension schemes.

## LABOUR-MANAGEMENT RELATIONS

Germany's achievements in both labour productivity and labour peace have been remarkable. An important factor in this situation has been the country's pioneering legislation in labour-management relations.

### National Arrangements

The Collective Agreements Act provides that agreements between employers and labour may be concluded only by trade unions and employers' organisations; as a result, both sides of industry are highly organised. Such agreements are binding on all members of the contracting bodies, and may be extended to related nonmembers if the parties concerned agree and the Federal Ministry of Labour so approves. Labour agreements are as a rule regional and by industry or trade, and cover wages, working and rest hours, annual vacations, and other social matters.

**Unions.** Labour unions are well organised; they are organised, however, by industry, not by craft. The separate unions have joined in the nationwide DGB (*Deutscher Gewerkschaftsbund*), which represents almost all labour with the exception of the small DAG (*Deutsche Angestellten Gewerkschaft* — Salaried Employees' Union). The DGB runs the country's fourth-largest private bank, owns enterprises, and invests generally in industry. Germany has the world's largest trade union — the 2½ million Metalworkers' Union.

While the right to join a trade union is guaranteed in the constitution, so is the right not to do so, and there are no 'closed shops' in Germany. The right to strike is authorised in most state constitutions, but the country's strike record was for many years among the lowest in Europe. Until 1973 at least, before inflation became acute, labour contracts were observed to a high degree and labour strife was practically non-existent. An important factor in the labour peace that has prevailed in Germany is the works council.

**Employers' Organisations.** Employers' associations, organised by region and industry, almost all belong to the Confederation of German Employers' Associations (*Bundesvereinigung der Deutschen Arbeitgeberverbände*). Employers do not bargain directly or independently with the unions, but act through their associations. Although membership is voluntary, these associations can be of great assistance to their members, especially to newly established enterprises.

**Labour Courts.** The system of labour courts is available for handling disputes not settled through other channels.

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## The Works Council

The works council (*Betriebsrat*) is the institution for employee participation in management. Although employee participation is practised in several European countries, Germany has carried the idea the farthest. The works council consists of elected representatives of all employees and has a primary duty of loyalty to the enterprise. It is not a separate group with which employers must deal, but an integral part of internal corporate management. A works council must be formed in every enterprise that has more than five employees, although this requirement is sometimes not enforced in small organisations. Members (1-31, depending on the size of the enterprise) are elected by secret ballot for three-year terms and represent employees in the organisation, regardless of union membership, although in practice such councils consist entirely of union members and work closely with the unions. (If one-fourth of the works council members so request, a union representative may attend the council meeting in an advisory capacity.) The council's meetings must be reported to management, and each quarter the council must report to all the other employees.

Under recent legislation, the functions of the works council include the consideration of social, personnel, and economic policies. Its approval is required for decisions affecting employment, such as mergers, plant relocations, or changes in production methods. A committee of the works council is authorised to inspect payrolls. It must ensure the enforcement of labour laws and collective agreements and act to settle grievances. It is authorised to enquire into such matters as change of work place, flow of work, work environment, hiring, promotions, holidays, hours, safety and health measures, training, payment procedures, and planning for redundancies. The employer must give prior information to the works council regarding these matters and must obtain its consent, which may be withheld within certain limits. Dismissals require the consent of the works council; without such consent, the employees concerned will remain on the payroll unless or until a labour court rules otherwise. It is almost impossible to dismiss a works council member.

Unsettled disputes between an employer and the council may be submitted to a 'unification board' (arbitration committee), composed equally of representatives of both parties and presided over by an independent chairman, appointed if necessary by the labour court. In practice, management and the works council work satisfactorily together, and in only a few material cases has there been an appeal to the unification board.

Enterprises with over 100 employees must also set up an 'economic committee' (*Wirtschaftsausschuss*). Such a committee comprises a small number of management and employee representatives with the right to receive and discuss periodic information on sales, production, and financial matters. The committee is consultative only and does not have power to approve or disapprove any activities.

### Workers and Company Policies

German public companies, and private companies with more than 500 employees, are required to have a two-tier board structure – a supervisory and a management board. The powers and duties of these bodies are described in Chapter 6, but can be summarised by saying that the supervisory board or *Aufsichtsrat* must approve all major policy matters and is the body that appoints and dismisses the members of the management board or *Vorstand*. Where there is such an *Aufsichtsrat*, the employees may elect one-third of its members (in coal, iron and steel companies, one-half, plus the right to elect a labour director or personnel manager to the *Vorstand*). The worker-members need not all be employees of the company concerned. Manual workers and white collar employees, other than *Vorstand* members, must all be represented. As described on page 15, a law is to be introduced whereby all corporate entities or groups with more than 2,000 employees must give equal representation on the supervisory board to shareholders and employees, including outside union nominees, with certain safeguards for the proprietors. In smaller firms, the present rules will continue to apply.

### Cost to Employers of Metalworkers' Fringe Benefits and Social Security

The costs listed in the following table are stipulated by law and in the negotiated collective agreement for the metalworking industry. The table illustrates the additional payroll costs referred to on page 53 and shows how these have grown in recent years.

		1975	1969
<b>Basis:</b>			
Hourly wages for work performed in 205 days per year:		<u>DM 10.00</u>	<u>DM 5.42</u>
<b>Social expenses</b>	<b>Days</b>	<b>DM</b>	<b>DM</b>
1. Paid leave: legal holidays	11	0.53	0.28
vacation	25	1.20	0.47
illness	18	0.87	0.05
employees'			
meetings (4 x 2 hrs.)	1	0.05	0.03
other cause	<u>1</u>	<u>0.05</u>	<u>0.03</u>
	<u>56</u>	<u>2.70</u>	<u>0.86</u>

(continued)

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		1975	1969
<b>Social expenses</b> <i>(continued)</i>		DM	DM
2. Special payments: additional vacation pay		0.58	0.14
collectively agreed-upon one-time			
payment based on monthly wages		0.39	—
employer's share of employees'			
savings plan		<u>0.18</u>	—
		<u>1.15</u>	<u>0.14</u>
3. Employer's share of social security and			
related charges:			
old age and disability			
insurance	9.0%	1.25	0.52
health insurance	5.3%	0.74	0.34
unemployment insurance	1.0%	0.14	0.04
other social laws	0.1% — 0.2%	0.02	—
industrial injuries, etc.,			
compensation	1.6%	0.22	0.10
additional illness benefit		—	<u>0.05</u>
		<u>2.37</u>	<u>1.05</u>
Total charge on basic wages		<u>6.22</u>	<u>2.05</u>
Percentage of basic wages		<u>62.2</u>	<u>37.8</u>



- INFORMATION FOR VISITORS
- BUSINESS HOURS
- BUSINESS PRACTICES

## INFORMATION FOR VISITORS

### The German Approach

Germans have a reputation for tough negotiations and for keeping to their bargains, and they respect similar qualities in their business counterparts. This does not mean that negotiations need be bleak or hostile, and a little humour will usually be appreciated.

'Playing it by ear' tends to be unwelcome among German businessmen, and a visitor should plan his approaches in a professional manner. Letters should be addressed to companies rather than to individuals until personal contacts have been established. A visitor requesting an interview should make sure his name, the object of his visit, and his probable travel programme are clearly stated. Unpunctuality and broken appointments create a bad impression, and notice of anticipated delays should be given as early as possible. The results of any negotiations should be confirmed promptly in writing.

The use of German will obviously be appreciated, and if an interpreter is needed, he should be given some idea beforehand of the technical points to be discussed. Interpreters are in great demand and may be unable to make appointment changes on short notice. An association of translators and interpreters that may be able to suggest suitable interpreters is the *Bundesverband der Dolmetscher und Übersetzer e. V. (BDU)*, 4100 Duisburg, Mulheimer Strasse 94 (tel: 357480).

The use of first names is usually restricted to family members and friends. German behavior tends to be formal, with frequent hand-shaking. Entertainment practices conform to those in other western European countries, but it is not good practice in Germany to talk about business outside office premises and hours, as at golf, for example. If a visitor is invited to his German colleague's home, he should take a small gift of flowers to the hostess.

### Best Travel Months

The best times for business travel to Germany are September – November and January – March. May – August, being popular holiday months, may find many business people away. The weeks before and

# Business Practices and Information

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after Christmas, Easter, and Whitsun, or other public holidays falling close to weekends, should also be avoided. Buying seasons are usually indicated by the timing of important trade fairs and exhibitions.

## Entry Requirements and Currency Restrictions

For a long-term stay or to conduct business in the Federal Republic, there are entry requirements, as described on page 46; but for a fact-finding trip or a holiday visit, only a valid passport, with in some cases a visa, is required. Travellers' cheques and foreign currency can easily be exchanged at banks, hotels, travel bureaus, airports, and frontier posts, and at many railway stations. There is no restriction on the amount of currency or travellers' cheques that may be taken into or out of Germany. However, as travel and currency regulations, including vaccination requirements, may change on short notice, prospective visitors should check with their West German Embassy or Consulate or with a reputable travel agent. There are no income tax clearance formalities for visiting businessmen leaving the country.

## Communications and Transportation

The largest seaports are Hamburg, Bremerhaven, Bremen, Wilhelmshaven, Lübeck, and Emden. There is a network of navigable rivers supplemented by many canals. Railways and highways are excellent. The famous *autobahns* provide a rapid means of travel, and there are good secondary roads, although traffic jams do occur, especially at holiday and vacation times. A foreign driver should take with him to Germany his driving licence, a vehicle registration record, and an international insurance certificate. Car hire facilities are readily available, and in towns at least taxi service is good, charges being about DM 1 per kilometre (approximately half a mile). Long-distance trains are fast, comfortable, and reliable although local service is not always frequent. *Personenzug* are local trains; *E-Zug* stop often, but not at every station; *D-Zug* are fast trains; *IC-Zug* are intercity expresses with first class accommodation only, at times carrying multilingual secretaries to deal with business correspondence; and *TEE-Zug* are first class trans-European expresses. *A word of warning:* be prepared to get off the moment the train stops — it only waits a minute or two, at intermediate stations, at least.

The largest airports are those in Frankfurt, Hamburg, Cologne, Bonn, and Munich, and air services link all the major cities. There are direct flights between German cities and most international centres by the national airline, Lufthansa, and others. Some airlines do not fly into West Berlin.

Telephone and postal services are widespread and reliable. Mail is delivered once a day in the morning. For overseas letters, airmail should be used. Stamps can be bought at hotels and post offices. Postal addresses have a numerical code shown as a prefix to the town name — for example, 6000 Frankfurt/Main — and the use of this code is obligatory.

International cables can be sent from post offices or private telephones, and most telephone calls can be dialled directly.

Telex is part of the postal services and is widely used. It is often available at hotels and at trade fair centres, and credit or charge facilities can be arranged.

Railways, highways, airports, seaports, major bus lines, and postal services are all state-owned.

## Hotels and Restaurants

Hotels are subject to government supervision and must meet required standards. Prices are controlled and must be exhibited at the reception desk and in rooms; prices include value added tax and usually a service charge. Rates vary from city to city. As a rough guide, a single room with bath in a good Frankfurt hotel would cost about DM 80 per night. While there is usually ample hotel accommodation in the larger cities, severe shortages occur in Frankfurt, Munich, and Hanover during trade fairs, and it is always advisable to book in advance. In Hanover at such times, prices may be increased by as much as 25%.

Restaurants, cafes, and *Gaststätten* usually provide substantial meals: dinner at a good restaurant can cost DM 20 or more. *Weinstuben* and *Bierkeller* serve drinks and provide good snacks; *Konditoreien* are pastryshops, famous for their cakes and pastries, especially in the south.

## Tipping

Tipping in Germany is a common practice. Hotels and restaurants add a 10 — 15% service charge to the bill and a value added tax. For handling baggage, a tip of DM 1 for each bag is customary. Chambermaids normally receive DM 2 or 3 if the visitor stays longer than one night. Tips are also expected by taxi drivers (not more than 10%) and cloakroom attendants (DM 0.50). For other services, the usual tip is DM 1. Cinema and theatre usherettes do not expect tips.



# Business Practices and Information

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## BUSINESS HOURS

### Commercial Offices

Offices are usually open from 8.30 to 17.30, Monday — Friday, although these times may vary by half an hour at either end of the day. Factories start earlier, but visitors should not arrange to arrive too soon after they open.

### Government Offices

These are usually open between 8.30 and 17.30, Monday — Friday.

### Banks

Banks are usually open from 8.30 to 12.00 and 14.00 to 15.30, or from 8.30 to 14.00, Monday — Friday. Most banks stay open on Thursday until 18.00.

### Shops and Post Offices

These usually open at 9.00 and remain open to 18.00 or 18.30. Some shops close on Saturday at 14.00, except for the first Saturday of the month when they stay open until 18.00 or 18.30.

### Time Factors

Germany uses Western Continental European Time, which is one hour ahead of Greenwich Mean Time. Time is not advanced during the summer months at present although an EEC proposal for standard daylight saving throughout the Common Market countries is being discussed.

## BUSINESS PRACTICES

### Public Holidays

Businesses are normally closed on the following public holidays:

January 1	New Year's Day	June 17	German Unity or Berlin Day
March/April (varies)	Good Friday Easter Monday	November 1	All Saints' Day (in Catholic regions)
May 1	Labour Day	November (varies)	Repentance Day
May (varies)	Ascension Day	December 25	Christmas Day
May/June (varies)	Whit Monday	December 26	Second day of Christmas
June (varies)	Corpus Christi Day (in Catholic regions)		

There are a few exceptions to this list and in addition various regional holidays are celebrated. The 'Catholic regions' referred to are Baden-Württemberg, Bavaria, Northrhine-Westphalia, Rhineland-Palatinate, and Saarland.

## **Weights and Measures**

The metric system is used for almost all weights and measures, although a few former measures have survived in certain trades. Temperatures are stated in centigrade. Domestic electric supply is standardised at 220 volts. Plugs are of the 2-pin type with earth strip, and lamp fittings screw in; adapters may be required for foreign appliances such as electric razors.

## **Dates**

Mistakes have sometimes occurred because foreigners have read dates incorrectly. The inscription '6.7.77' in Germany should be read as 6th July 1977, and not June 7, 1977, as in North America. The sequence in Germany, as in Europe generally, is day-month-year. In 1971, Germany, like most other advanced trading nations, voted in favour of a new international standard for use when dates are expressed in figures only. Under this standard, not yet widely adopted, the sequence is year-month-day.

## **Writing Conventions**

Figures in Continental Europe, including Germany, are separated by periods (full stops), not by commas, but commas precede decimals. For example, 1.000,99 would be written in English-speaking countries as 1,000.99.

The figure seven usually has a line drawn across the stem (i.e., 7) when written by hand, to differentiate it from figures one and four.

## **Business Customs**

Business cards should always be offered and should be in Latin script, rather than, say, Japanese or Arabic. Several international credit cards, including the recently introduced Eurocredit card, are accepted in many hotels, restaurants, shops, and airline offices.

Although Germans have a reputation for being rather formal, the visitor will note many interesting customs, such as the exchange of good wishes before meals and the attractive decorations of even such mundane places as staff canteens (cafeterias) at Christmastime.



# Forms of Business Entities

- PRINCIPAL BUSINESS ENTITIES
- AG CORPORATIONS
- GmbH COMPANIES

- BRANCHES
- PARTNERSHIPS AND OTHER ENTITIES

## PRINCIPAL BUSINESS ENTITIES

Business entities are regulated by the Commercial Code and by a number of individual Acts of the Federal Parliament. Reforms of the private limited liability company law are awaited, and as in other European Common Market countries, EEC directives may result in further changes. The descriptions that follow are of the present position.

In Germany, stock corporations and limited liability companies are legal entities separate from their members. The various types of partnership do not have full legal capacity, although, like the corporate bodies, they may own real estate, enter into contracts, sue and be sued, all in their own names. A civil law association, which is frequently used for joint-venture purposes, is not a legal entity and cannot sue or be sued.

### Summary of Forms

A prospective investor in Germany has a choice of the forms he may adopt for his enterprise.

1. Corporation (*Aktiengesellschaft* or *AG*). This is the usual form for large incorporated enterprises; liability is limited, and issues of shares or bonds can be made with few restrictions only, through the stock exchange or otherwise.
2. Limited liability company (*Gesellschaft mit beschränkter Haftung* or *GmbH*). This type of enterprise is suitable for small traders; again liability is limited, but shares cannot be transferred freely, and the issue of bonds is generally limited to private placing. A subsidiary company (*Tochtergesellschaft*) is often formed as a GmbH when the parent company provides all required finance.
3. General commercial partnership (*offene Handelsgesellschaft* or *OHG*). All partners are jointly and severally liable for all debts of the partnership.
4. Limited partnership (*Kommanditgesellschaft* or *KG*). In this form, one or more general partners are fully liable as in an OHG, but there are one or more limited partners liable only to the extent of the capital contributions they have made or promised to make to the partnership.

# Forms of Business Entities

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A special type of KG that is sometimes of interest is the 'GmbH & Co. KG,' in which the general and thus nominally unlimited partner is itself an entity with limited liability, usually a GmbH, although sometimes even an AG. Although the *Kommanditgesellschaft auf Aktien* or KGaA from its name is a limited partnership with transferable shares, it is governed by the AG corporation law and is more appropriately considered a corporation in which certain members manage the business and have unlimited liability.

5. Branch of a domestic or foreign company (*Zweigniederlassung*). This is not a separate legal entity but an establishment of its parent body, in whatever form that body carries on its business.

6. Other forms include sole traders, foundations, associations, and cooperative societies. Civil law associations can be used for certain commercial purposes although the commercial law does not apply. As an alternative to setting up a new enterprise, an investor may buy an interest in an existing German organisation.

## AG CORPORATIONS

The corporation (*Aktiengesellschaft*) is the usual form of a business organisation if financing is to be raised from the public. Its general characteristics are similar to those of a corporation or public company as understood in most other countries. It has its own legal identity, and provided that its shares are fully paid up, its creditors have no claim against its shareholders. It has the status of a 'merchant' and so must comply with the Commercial Code described on page 36, and with the AG corporation law of 1965. The KGaA form is also governed by the AG corporation law. This form is rarely used, and therefore no further reference is made to it in this study, although one or two well-known examples still operate.

### Formation Procedure

The founder-shareholders prepare the articles of incorporation and appoint the first members of the supervisory board, who then appoint the members of the management board. There must be at least five founders. After a minimum of 25% of par value of the shares subscribed by the founders has been paid in, the founders and the members of both boards jointly file an application with the local court through a notary for the registration of the corporation in the Commercial Register. The court must be that of the district in which the legal seat is to be situated. All documents require certification by a notary or before a court. Upon registration, the corporation comes legally into existence.

The five founders may be individuals, domestic or foreign corporate bodies, or even partnerships. The founders can be represented at the foundation meeting, usually held before a notary, by holders of powers of attorney, as described on page 16, thus saving foreign founders from having to travel to Germany for the occasion.

**Articles of Incorporation.** The articles of incorporation (*Satzung*) combine the charter of incorporation and the internal regulations or bylaws. The articles must contain at least:

1. The name of the AG and its registered address or legal seat (*Sitz*).
2. The object.
3. The amount of share capital.
4. The par value and number of each class of shares and whether in registered form.
5. The number of members of the management board.
6. The procedure for the publication of the corporation's official notices.

The corporation's name, which must have been approved by the local chamber of commerce, must indicate the general purpose of the enterprise and include the word *Aktiengesellschaft* or the abbreviation AG. The legal seat need not be the place where the management or administration is located, but it must be within the Federal Republic or West Berlin.

The amount of the share capital must be at least DM 100,000. Individual shares (*Aktien*) must have a nominal amount of at least DM 50; and if larger denominations are issued, they must all be in multiples of DM 100. If registered shares (*Namensaktien*) are to be issued rather than the much more usual bearer shares (*Inhaberaktien*), this fact must be stated in the articles; if the shares are not subscribed for in cash, the nature and value of the property contributed and the name of the vendor must be described there also. The articles must be in the German language. They do not usually set out all the bylaws in detail as procedures are laid down in the AG law of 1965.

**Other Formalities.** If any shares are to be issued for a consideration other than cash, formation auditors are required who must evaluate whether the contributed property has been fairly assessed. Formation

# Forms of Business Entities

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auditors are also required if a member of either board is one of the founders, has subscribed for shares on behalf of any of the founders, or expects to receive any special advantage from the formation. Formation auditors are appointed by the local court after the views of the local chamber of commerce have been heard.

All relevant documents must be attached to the application for registration in the Commercial Register; examples are the articles of incorporation, any special contracts (for instance, conferring of special advantages to the founders or providing for capital contributions in kind), a statement of the formation costs to be borne by the corporation, documents appointing the members of both boards, the reports of both boards on the formation, the formation auditors' reports, and the specimen signatures of the members of the management board.

The registration, together with abbreviated information about the corporation, is then announced in the Federal Gazette and in the newspapers selected by the corporation and approved by the court for its official notices. Branch offices can be established thereafter through the court with which the principal office is registered.

Before registration is completed, the founders are personally liable towards any third party for their actions on behalf of the proposed corporation; but when properly formed, the corporation may take over any obligations they have incurred.

It can take between two to four months to organise and register a corporation. Permit and general registration requirements concerning all new entities are described in Chapter 2.

**Acquisition of Existing Corporations.** The acquisition of a dormant corporation has no advantage over the formation of a new one since normally a tax loss carry-over cannot be transferred, and it is unlikely that any time will be saved by adopting this alternative.

## Cost of Incorporation

The formation costs of an AG consist of the notary's scale fee for the preparation and certification of its articles and the application for its entry in the Commercial Register, and the cost of publication in the Federal Gazette and the corporation's selected newspapers. Costs amount to approximately DM 1,000 for a corporation with a share capital of DM 100,000, and DM 2,750 for a share capital of DM 500,000. In addition, a capital transactions tax is payable at 1% of the

share capital subscribed, including any premium. These figures do not include professional fees such as those of accountants, tax advisers, or translators, nor the fees of any required formation auditors.

## **Shares and Shareholders**

Minimum capital on formation and denominations of shares have already been described. On formation, the whole of the share capital must be subscribed, and at least 25% of the nominal value and the whole of any share premium must be paid in. Any contribution to capital other than cash provided for in the articles (for example, tangible assets, legal claims, or know-how) is excluded from this 25% rule. The issue of shares with no par value is not permitted, nor is the issue of shares at a discount on nominal or par value.

The founders' shares must be in registered form until fully paid up. Thereafter, they usually become bearer shares. Bearer shares are preferred to registered shares because transfer is so simple — merely by delivery to the new owner or, in practice, by giving appropriate instructions to the bank holding the shares in safe custody. Registered shares are transferred by endorsing the certificate and presenting it to the corporation for entry in shareholder records. If shares are in registered form, the corporation's articles may require the management board to refuse a transfer unless its consent is obtained. The buying and selling of shares are usually transacted through banks, whether or not the corporation has a stock exchange quotation. Shareholders can be residents or nonresidents, individuals or corporate bodies.

A corporation may acquire up to 10% of its own share capital, but only to avert a dangerous situation (for example, a threatened takeover), to redeem shares, or to issue shares to its employees. It cannot exercise voting rights on such shares even if held by a third party for its account.

Besides ordinary shares (*Stammaktien*), a corporation may, if so empowered by its articles, issue preference shares (*Vorzugsaktien*) up to the amount of its ordinary capital. Preference shares usually have special rights regarding the distribution of profits or repayment on dissolution, but do not carry votes except on any question of modification of their rights. Modification requires approval by at least a 75% majority of the preference shareholders.

## **Management of an AG**

As the concept of the limited liability enterprise developed with the growth in size and complexity of business entities and in the number of

# Forms of Business Entities

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shareholders, German legislators recognised the need for some body that could exercise effective control over management. Their solution was to introduce into AG corporation law a two-tier board structure — a management board (*Vorstand*) and an independent supervisory board (*Aufsichtsrat*). It is interesting to note that the EEC Commission is considering the harmonisation of corporation laws in Common Market countries based on the German model, although it may take several years before any agreement on this point is reached.

**The Management Board.** The management board is responsible to the supervisory board and the shareholders for everyday management, subject to limits set out in law or in the articles or imposed by the shareholders or the supervisory board. Such limits do not restrict the corporation's responsibility to third parties, however, even if the management board is found to have acted beyond its powers. If the corporation's share capital exceeds DM 3 million, the management board must have at least two members, unless the articles provide otherwise.

Members of the management board are appointed and dismissed by the supervisory board, which also concludes their employment contracts, including remuneration and bonuses. Appointments are limited to a five-year period, but prolongation of service or reappointment is possible. Members may be of any nationality, and need be neither shareholders nor German residents. Members must be individuals, as corporations cannot act as managers, even through representatives. Changes in the composition of the management board must be reported to the Commercial Register and published in the manner already described. The board may make its own rules as to meeting places and voting methods, but normally decisions are taken on a majority vote. A chairman of the management board may be nominated by the supervisory board, but he is not authorised to make final decisions as if he were a sole general manager.

The management board must call the annual shareholders' meeting. It must report quarterly to the supervisory board on the company's situation — its policies, sales and profitability, and liquidity — and must also report in advance on any major transactions contemplated. The management board must provide for the keeping of books as required by law and must prepare the annual financial statements and management report within three months after balance sheet date (five months for consolidated accounts). There are strict rules on the duties of the management board if losses are incurred or in the case of insolvency, and on its duty to conduct the corporation's business with diligence and re-



sponsibility and its members' liabilities if they do not do so. If management board members wish to borrow from the corporation, this must be approved in advance by the supervisory board, and the loans must be disclosed in its published balance sheet.

Although management board members have collective responsibility as the legal representatives of the corporation, they may delegate authority for certain transactions to either one or more of its members or to senior officials such as the *Prokuristen* described on page 37.

**The Supervisory Board.** The supervisory board consists of representatives of shareholders and employees. Members of the first supervisory board are appointed for one year by the founders, and thereafter members are appointed by the shareholders and employees for five-year terms. Shareholders must accept the elected employee representatives, and the employees must accept those elected by the shareholders.

The size and composition of the supervisory board depend on whether the number of employees exceeds 2,000. For an AG with less than 2,000 employees, representation of labour is limited to one-third of the board; and the maximum number of board members is related to the size of the share capital (up to DM 3 million, 9; up to DM 20 million, 15; and over DM 20 million, 21 members). In an AG (or GmbH) employing 2,000 or more employees, the number of supervisory board members will depend on the number of employees in the future instead of on the size of the share capital. One-half of the members will be elected by the shareholders and one-half by the employees, so that there will always be an even number. In stalemate situations, the chairman, elected by the shareholders, will have a casting vote.

A supervisory board member is not permitted to be a member of the management board of the corporation, or of any of its subsidiaries or its holding company, or to be a key employee (except that a supervisory board member may take the place of an incapacitated managing employee for not more than one year, during which period he must be released from his functions as a supervisory board member). Any change in the composition of the supervisory board must be reported to the Commercial Register and published.

Members must be individuals and not corporations, but there are no rules as to nationality or residence. However, no person may be a member of more than ten supervisory boards. Quite often, bankers or prominent independent industrialists are asked to join a corporation's supervisory board.

# Forms of Business Entities

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The main functions of the supervisory board are:

1. Appointing, dismissing, and generally controlling the board of managers.
2. Approving of certain major transactions. Although management functions cannot be conferred on the supervisory board, that board or the corporation's articles may determine that certain transactions can be undertaken only with its consent. Examples are capital expenditure, real property deals, raising of loans — all in excess of defined limits — and the conclusion of important contracts such as, in practice, mergers or plant closures (subject to shareholders' final consent) and the employment of key staff.
3. Inspecting the corporation's assets.
4. Calling shareholders' meetings if circumstances so require.
5. Examining and reporting to shareholders on the annual financial statements and the management and auditors' reports.
6. Considering the management board's proposals on the appropriation of profit and the final decision, with the management board, on the annual financial statements.

The supervisory board elects a chairman and a vice-chairman, and may appoint committees from among its members for special purposes. The chairman normally presides at shareholders' meetings. As a rule, the board meets once each quarter, but it must meet at least twice a year. The members decide their own rules as to methods of voting and places of meeting. Votes in writing, by cable or telephone, are permissible if no member objects. Resolutions are passed by simple majority. Members' duty to be diligent and their liability for the proper discharge of this duty are similar to those of the management board. The shareholders fix the remuneration of the supervisory board members, if this is not stipulated in the articles.

**Shareholders in General Meeting** (*Hauptversammlung*). Each year, the management board must call a general meeting within eight months of the end of the previous financial year.

From the date the meeting is called, the financial statements and reports of both boards and their proposals for the appropriation of earnings must be made available to the shareholders. Although the share-

holders are generally bound by the resolution of the boards regarding appropriations, they may decide to transfer additional earnings amounts to retained reserves. The shareholders have ultimate power, as they control the appointment and dismissal of the chairman of the supervisory board, who has a casting vote in case of any deadlocked dispute with the employees' representatives. General meetings are held at the corporation's legal seat or at such other place as its articles of incorporation may provide.

The shareholders are also responsible for discharging the members of both boards from their responsibilities each year; appointing auditors; amending the articles; approving mergers, changes in corporate status or capital; and deciding to dissolve the corporation.

Other general meetings of shareholders may be called by a majority vote of either the management or the supervisory board. Shareholders representing 5% of the share capital (or such smaller proportion as the articles may specify) may requisition a meeting.

A general meeting is called by giving at least one month's notice in the newspapers approved for the corporation's announcements. The notice must state the agenda for the meeting, including the resolutions to be proposed. This information will be passed to individual shareholders by the banks with which they have deposited their shares. Shareholdings by nominees are not prohibited by law, but holdings by other entities of more than 25%, however arranged, must be disclosed to the corporation, which must then notify the Commercial Register.

Within a week of publication of the notice, any shareholder may submit amendments or further resolutions, and these must be similarly communicated. No quorum rules are provided by law, and any members present in person or by proxy constitute a quorum. Proxy votes are allowed at general meetings if the proxies have been appointed in writing. Holders of bearer shares must deposit their certificates with a bank or public notary at least ten days before the meeting so that attendance or proxy representation can be arranged. Each ordinary share carries one vote, and multiple voting rights are not permitted.

All the members of both boards are required to attend every shareholders' meeting. At the meeting, every shareholder is entitled to receive information from the board of management on any of the subjects of the agenda, unless this is refused for reasons allowed by law (for example, if the giving of information might be expected to cause considerable damage to the corporation or any connected enterprise).

# Forms of Business Entities

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Minutes recording the resolutions passed, and a list of shareholders attending, must be prepared by a notary and filed in the Commercial Register.

Resolutions are normally passed by simple majority vote. For major decisions such as capital increases, changes in the articles, or dissolutions or mergers, approval by holders of at least three-quarters of the shares represented at the meeting is required. A holding of more than 25% thus gives its owner a blocking holding unless for this purpose the articles restrict voting rights. A change from AG to GmbH status requires unanimity at the meeting (unless redemption of shares in cash is offered).

## Controlled Corporations

If an AG becomes partly owned by another enterprise, there are important rules to be followed designed to protect the interest of minority shareholders. Whenever the investment of an enterprise, of whatever legal form, reaches 25% of the share capital of an AG, the AG must be informed of that fact. This must be done again when the investment reaches 50%.

If the AG corporation then agrees to certain actions, its shareholders must approve by a three-quarters majority. The actions referred to are transfer of its management operations to the other enterprise, resulting in loss of its independence (subordination agreement); transfer of its annual earnings to the dominant enterprise; pooling of profits and losses (profit transfer agreement); or lease of its business to another enterprise. Any such intercompany agreement must be recorded in the Commercial Register before it becomes valid. In the case of both a subordination agreement and a profit transfer agreement, the minority shareholders are entitled to be adequately compensated by dividend guarantee or equalisation payment. Furthermore, the minority shareholders must be given the right to dispose of their shares to the dominant enterprise on agreed terms.

If control of a subordinate AG corporation is achieved through share purchases without an intercompany agreement being concluded, the dominant enterprise may not require the subsidiary AG corporation to enter into any detrimental transactions. In this case, the annual management report of the subsidiary AG must list all intercompany transactions and must certify that the subsidiary has not been adversely affected thereby, and this statement or 'dependency report' (*Abhängigkeitsbericht*) must be reported on by the auditors. Shareholders have a right of appeal to the courts concerning such arrangements.

## Capital, Reserves, and Dividends

**Capital.** The protection of creditors is an important consideration in Continental European company law. One aspect of this is the requirement that every corporation must have a minimum share capital, as described on page 69. On a reduction of capital, the creditors at the time are protected by the recording of the reduction in the Commercial Register and, under certain circumstances, being given security for the amounts not yet due for payment to them.

Any increase in share capital is normally made by a 'rights issue,' that is, the shareholders have a preemptive right to the new shares in proportion to their existing holdings. Usually a syndicate of banks subscribes for all the new shares and then offers them to the present shareholders. Registration and publication procedures are similar to those that have to be observed on formation.

On a proposal of the board of management made with the consent of the supervisory board, the shareholders may resolve to increase the share capital in the form of conditional capital (*bedingtes Kapital*) or to authorise the creation of additional capital. A conditional or reserved capital increase may be used only to issue new shares to holders of convertible bonds, for merger transactions, and to implement employees' stock option plans. The creation of authorised capital (*genehmigtes Kapital*) avoids the calling of a special shareholders' meeting when further capital is required. Such authorised capital must be issued within five years after registration, against further contributions by shareholders.

Shareholders can also increase share capital by capitalising free reserves, but not retained earnings, as stated in the last balance sheet. However, any revenue deficiency must have been made good before reserves may be capitalised. A capital increase or decrease requires an amendment to the articles of incorporation.

**Reserves.** A legal reserve (*gesetzliche Rücklage*) of at least 10% of share capital must be built up by appropriations of 5% of each year's net profit, after meeting losses brought forward. In addition, share or convertible bond premiums (paid-in surplus) must be credited to this reserve. The legal reserve can be capitalised, providing the 10% rule is maintained, or used to meet losses if all other reserves are exhausted, but may not be distributed as dividend.

Up to half the amount of the annual net profit (after the legal reserve requirement has been met and past losses have been recovered) may be transferred to free reserve accounts (*freie Rücklagen*), which are avail-

# Forms of Business Entities

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able for future use in any way. The power of the boards to make such transfers ceases when the free reserves reach one-half of the share capital, unless the articles provide otherwise.

**Dividends.** Shareholders are entitled to cash dividends; scrip dividends are not known. An AG cannot pay an interim dividend nor distribute the annual dividend before approval at the shareholders' meeting. However, a limited payment on account of the annual dividend after the close of the financial year may be allowed by the articles, but is very unusual.

**Losses.** The management must call a shareholders' meeting if more than 50% of the share capital is lost. If more than 100% of the share capital is lost, or in case of insolvency, management must take measures to improve the situation by increasing capital, raising of shareholders' loans, or making arrangements with creditors (or a combination of these steps). Otherwise, management must announce a settlement with creditors or the bankruptcy of the corporation in the Commercial Register. Management board members are personally liable to fines or prison sentences if the corporation continues to incur liabilities when it is insolvent.

**Financing by Loan Capital.** Debentures and bonds are major sources of long-term loan capital. In addition, an AG may issue convertible bonds (*Wanderschuldverschreibungen*) and, although very unusual, participating bonds (*Gewinnschuldverschreibungen*). The issue of these securities requires the approval of the government and that of the shareholders by a three-quarters majority. The shareholders have a preemptive right to subscribe for these types of capital. When certain ratios are met and after a fixed period of time, the conversion right may be exercised. The shares to be issued against the convertible bonds (normally interest-bearing) are provided by the creation of conditional capital, and the two resolutions (one on the issue of the convertible bonds and the other on the creation of conditional capital) are always passed at the same time. Trading on a stock exchange requires the issue of a prospectus for listing. These types of capital are always issued in bearer form, and the holders are not members of the corporation.

## Registration and Publication Requirements

The registration and publication of information required on the formation of an AG are described in the section on 'Formation Procedure' on page 68.

Other information required from time to time includes:

1. Administrative.

a. Changes in the following must be reported to the Commercial Register and published as described below:

- address of the principal office
- membership of the management and supervisory boards
- articles of incorporation, including capital
- relationship with group companies (see, for example, page 76).

If shareholders resolve to liquidate, this fact must be reported to the Commercial Register, together with the liquidators' names.

b. A corporation's official notices about general meetings, payment of dividends, prospectuses of offers of shares or bonds must be published in the Federal Gazette and additionally in other newspapers as authorised by the articles of incorporation. Generally, prospectuses also appear in the stock exchange gazette and other papers.

c. Information to be shown on business stationery is described on page 40.

2. Tax returns. These are dealt with in Chapter 8.

3. Annual accounts. All AG corporations must prepare an annual business report, which must be made available to shareholders when the annual meeting is called. This document consists of management and supervisory board reports, balance sheet, and profit and loss statement, and the auditors' opinion thereon. The contents of the annual report, and publication requirements generally, are dealt with in Chapter 7.

## Liquidation and Dissolution

An AG may be liquidated and dissolved if it becomes insolvent, on expiration of its life, or if so resolved by a 75% majority at a shareholders' meeting. The liquidators may be members of the management

# Forms of Business Entities

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board or other persons appointed by the shareholders or the court. The liquidators must prepare an opening balance sheet and subsequent financial statements as appropriate, and require creditors to report their claims. The net assets of the corporation may be distributed to shareholders only a year later, after notices to creditors to submit their claims have been published three times.

If a corporation becomes insolvent and the management board members do not report this fact to the shareholders and Commercial Register, they may be held liable for fines or even prison sentences.

## GmbH COMPANIES

In Germany, the limited liability company (*Gesellschaft mit beschränkter Haftung* or *GmbH*) is a different entity from the AG corporation. It is governed by a law of 1898. As in other countries in Continental Europe, it developed from the concept of a group of associates with personal relationships seeking to trade with limited liability, rather than as a small example of a widely-held corporation, which is the tradition in English-speaking countries where companies with many thousands of shareholders and those with only two or three are organised under the same statute.

The limited liability company is a legal entity, may acquire property and rights, and sue and be sued. Its liability to creditors is limited to its own property. Like an AG, it has the status of a 'merchant' and so must comply with the Commercial Code. The GmbH law at present offers flexible statutory rules, informality in conducting its affairs and, with the exception of companies of a certain size (page 91), no publication requirements. As the regulations concerning a GmbH are less strict than the AG rules, the GmbH is the form most used for small and medium-sized businesses and by foreign enterprises with subsidiaries in Germany. At the end of 1973, out of 11,000 commercial entities in the country with foreign participation, 9,000 were GmbH companies. Mortgage banks and insurance operations, however, cannot be organised in the GmbH form. Proposed amendments to the GmbH law are summarised at the end of this section.

## Formation

Incorporation is simple. Two or more founding partners (individuals or corporate bodies) prepare articles of agreement (*Gesellschaftsvertrag*) for signature by them and the proposed manager(s) before a notary public. One partner may in practice be a mere nominee, such as a professional



adviser, who after formation will transfer his share (strictly called a 'business interest,' *Geschäftsanteil*) to his principal, who will then become the sole proprietor. Such a company is sometimes referred to as a 'one-man company (*Einmann-Gesellschaft*).' A founding partner need not appear in person before the notary, but a proxy-holder must produce a certified power of attorney before he may act (page 16).

The article of agreement must contain at least:

- name of the company and its registered address or legal seat (which must be in the Federal Republic or West Berlin)
- purpose of its intended business
- amount of its capital
- subscription and, with dates, contributions of each member
- duration of the company, if this is limited
- obligations of the members in addition to contributing capital
- details of non-cash contributions by specified members.

The company's name should first have been approved by the local chamber of commerce. It must give an indication of its activities or of the names of one or more of its members, and must include the words or abbreviation 'GmbH.' A subsidiary may refer to its parent's name.

Other advisable provisions concern:

- procedure for giving notices to members (newspaper publication is not required)
- procedures at members' meetings, such as proxies, voting rights, location, and majorities required for extraordinary business
- rules for approval of share transfers
- definition of accounting year
- whether AG corporation law, accounting, and valuation principles are to be followed

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- whether there is to be a supervisory board
- powers of the managers to represent the company.

The articles must be in German.

The first managers are appointed by the founders, and the minimum capital described on page 83 must be put at their disposal. The managers must then, through the notary, register the company in the Commercial Register at the local court, when the following must be filed:

- articles of agreement, signed by or on behalf of all members, together with certified powers of attorney authorising any proxy signatures
- evidence of the appointment of managers and their specimen signatures
- names, addresses, and occupations of all members
- acceptance by the managers of the cash subscription to capital.

On registration, the GmbH comes into existence, and the personal liability of the founders for its actions ceases.

Branch offices can thereafter be established through the same court with little formality. The time taken to complete registration, after all documents required are available, depends on the place of registration; in larger cities, registration may take longer than in more remote places where it may be completed in about four weeks. Permit and general registration requirements concerning all new entities are described in Chapter 2.

## Cost of Incorporation

The formation costs of a GmbH, including certification by a notary public and entry in the Commercial Register and publication, but excluding accountants' and other advisers' fees, amount to about DM 500 for a company with a capital of DM 20,000 and to about DM 1,000 for a capital of DM 100,000. A capital transactions tax of 1% on the amount contributed is payable prior to registration. As in the case of an AG corporation, there is little advantage in acquiring a dormant GmbH rather than forming a new one.

## Shares and Members

The capital of a GmbH is divided into 'business interests,' but for brevity these are referred to in this chapter as 'shares.' Share certificates are not issued; shares can only be transferred by notarial deed. The company's written consent to any transfers may be required by its articles, and the transfer of part of a share always requires such consent. Shares cannot be quoted on a stock exchange.

The minimum capital of a GmbH is DM 20,000, and the minimum amount of each share is DM 500. Shares need not be of the same amount, though all must be in multiples of DM 100; for example, if upon formation there are two founder-members, one could take a share of DM 500 and the other a share of DM 19,500. The whole capital must be subscribed on incorporation, and at least 25% of each share (minimum DM 250) must then be paid in. Subscriptions other than cash, for instance by contribution of inventory or transferable know-how, must be for the full amount of the share concerned. In this case, the articles must specify the property so subscribed, which may be subject to independent valuation. All members are jointly liable for unpaid subscriptions. On formation, each member may apply for one share only, although shares may later be subdivided as long as the rules described above are followed. Preference shares (*Vorzugsanteile*) may be issued. There are no restrictions on the number or nationality of the members.

A GmbH may not acquire its own shares if these are not fully paid or, if fully paid, only with funds available to the company represented by reserves. The creation of a legal reserve is not required by law, but the articles of agreement may provide for the setting up of free equity reserves. If losses are incurred, the same rules as those for AG corporations apply. Members may convert any loans they have made into capital to avoid insolvency.

A GmbH may raise loan capital like an AG, but as a rule this is not quoted on a stock exchange. The raising of loan capital also depends on the availability of real property, as this is usually required to be given as security. Unlike an AG, however, the loan capital of a GmbH may be secured by guarantees given by its members.

## Management

**Managers.** The business of a GmbH is conducted by one or more managers (*Geschäftsführer*), who need not be German nationals or residents, nor need they be members. Such managers are responsible for the company's affairs to the members, who set their remuneration un-

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less this power is transferred to a supervisory board. Managers' powers may be restricted by the articles, the members, or the supervisory board, but their transactions with third parties are binding on the company. A nonresident manager should appoint a resident deputy answerable to the authorities for the proper conduct of the company. A GmbH, like an AG, can appoint *Prokuristen* and other company officials.

Managers' liabilities and duties are similar to those of members of the *Vorstand* of an AG, and in particular include the keeping of proper books and the preparation of financial statements for final determination by the members. If more than one manager is appointed, the company may be represented by any two or by one, together with a *Prokurist*. The members may, however, give full powers to any one manager to bind the company.

**Supervisory Board.** Unlike an AG, there need be no supervisory board (in a GmbH also called an *Aufsichtsrat*, although sometimes a *Verwaltungsrat* or *Beirat*) unless the normal number of employees regularly exceeds 500, when worker representation as in an AG must be allowed. A smaller GmbH may, however, provide for a supervisory board in its articles if it so wishes. Where there is such a board, its powers and duties are normally similar to those of an *Aufsichtsrat* of an AG.

**Members' General Meetings.** Members in general meeting have ultimate authority, voting powers being proportionate to holdings. Generally, one vote is allowed for every DM 100 of capital, but the articles may provide for multiple votes. Usually, members may not vote on questions concerning transactions in which they have a private interest. Votes may be in writing if all members agree. The articles may define the period of time within which the annual general meeting must be held, procedure for notices, quorums, proxies, and methods of voting, and whether general meetings must be held in Germany; alternatively, these matters may be left to the members to decide. Meetings, annual or special, are called by the managers, but members representing 10% of the capital are empowered to call meetings if necessary. The business of the annual meeting includes the determination of the accounts and the appropriation of profit, and the discharge of each manager from his responsibilities for the year. Other business that can be transacted includes subdividing of shares, increasing capital, calling up unpaid capital, or appointing *Prokuristen*. In line with the concept of a GmbH as a group of associates, the members are by statute entitled to the whole of the net profit, but normally the articles provide, or the members may decide, to place part of the profit to reserve, to retain it as unap-

propriated profit, or to pay only a small dividend. Unless the articles provide otherwise, a simple majority vote is sufficient to carry resolutions of this sort, and a notary need not be present to authenticate the minutes. At least a 75% majority is required in order to change the articles, including the share capital, or to dissolve or liquidate the company, and such resolutions must be authenticated by a notary. Dissolution procedures are similar to those for an AG corporation.

## **Registration and Publication Requirements**

Documents required for public inspection at the Commercial Register on formation are described on page 80. Any subsequent changes in that information, certified by a notary, must be recorded in the Register. In January of each year, a list of members with their holdings showing changes during the year must be filed in the Register.

Annual financial statements of a GmbH company do not have to be audited or published unless it is a 'large enterprise,' as defined on page 91, or has an AG subsidiary. If the GmbH is a bank, its financial statements must be audited, but need not be published.

## **Reform of the GmbH Law**

Since 1969, a revision of the GmbH law has been pending, but has been held up in order to incorporate proposed EEC accounting provisions for the harmonisation of company law in the Common Market, which in particular would require the publication of audited financial statements by many GmbH companies. Reform proposals would require that the minimum share capital be increased to DM 50,000, of which at least half would have to be paid up and that stricter control be exercised on the subscription of capital other than for cash and on formation procedures in general. Existing GmbH companies would be given five years in which to increase their capital to the new minimum.

Because of the delay in the issue of the EEC directives on company law, it is uncertain when and to what extent the reforms will be enacted. In spite of the more stringent provisions to be expected thereafter, the GmbH form of company may remain the most appropriate corporate form for the German subsidiary of a foreign company.

## **BRANCHES**

A branch office (*Zweigniederlassung*) of a domestic or foreign enterprise is not itself a separate legal entity but derives its rights and obligations from its parent body. A branch of a foreign enterprise is treated

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like that of a domestic enterprise; its existence begins when it commences operations and not with its registration in the Commercial Register at the place of its establishment. Before the branch starts operations, the parent enterprise must obtain a permit from the local trade supervisory agency, and the other formalities described in Chapter 2 must be complied with. Enterprises from outside the EEC require, in addition, a permit from the State Ministry of Economics to establish the branch. The applications to both the Commercial Register and the State Ministry must provide evidence that the enterprise would itself be eligible for registration if it were located in Germany, the main point being that creditors must be adequately protected. In the case of a company, for example, the foreign organisation would have to show that it met the minimum capital requirements applicable to comparable German enterprises. The payment of capital transactions tax is described on page 153. A parent enterprise must register its branch in the Commercial Register at the local court if the branch is to be established for long and carries on business as defined in Section 1 of the Commercial Law Code. The branch must then keep proper account books.

## Formation

The formalities are few and the cost is normally small. Application must be made by the parent enterprise for registration in the Commercial Register at the local court of the district in which the branch will be located, and the application letter must be signed by the legal representative(s) of the parent or a proxy, all documents having been certified and legalised.

If the foreign enterprise is a corporate body, the application for registration must be accompanied by a notarised copy of its charter and bylaws; its last three annual accounts; and the names, addresses, and qualifications of its management board and proposed branch managers. All documents in another language must be accompanied by a German translation certified by a notary or consul. The branch managers' signatures must be recorded in the Commercial Register.

Because of these requirements by the German authorities, registration of a branch may take several months. However, registration of a branch, unlike that of a company, is only a matter of record and does not affect the legality of the acts of the branch.

## Publication

All changes in the documents or particulars made public through the Commercial Register on formation must be registered. Branch accounts do not have to be published.

## Administration

The name of the branch must be the name of the parent body with the addition of the place of operation and the word 'branch.' The parent may sue and be sued through the branch. Because the branch is not a separate German entity, there is no question of constituting a supervisory board or representation of employees. A branch cannot enter into a licence agreement with its head office. Books and vouchers should be retained in Germany in case they are required, by tax auditors, for example but in general there are no extra regulations that branches, as compared with other forms of enterprise, must observe. The question of whether 'branch or subsidiary' depends mainly on the taxation factors described in Chapter 8.

## PARTNERSHIPS AND OTHER ENTITIES

### Partnerships

Partnerships are quite common in Germany. Partners may be individuals or corporate entities. Of the hundred largest German firms in 1974, five were partnerships.

The two main forms of commercial partnership are the general partnership (*offene Handelsgesellschaft* or *OHG*) and the limited partnership (*Kommanditgesellschaft* or *KG*). Both are entities that can sue or be sued in the courts. Interests in a partnership can only be transferred with the consent of the other partners, and the death or retirement of an unlimited partner results in the dissolution of the partnership, unless the partnership agreement (*Gesellschaftsvertrag*) provides otherwise.

All partners of an OHG are personally liable without limitation. A KG must have at least one active partner who is liable without limitation (*Komplementär*) and one or more limited partners (*Kommanditisten*) who are liable only to the amount of their capital subscription as recorded in the Commercial Register. Limited partners may not usually take part in management, nor may their names appear in the firm name, although they have the right to examine the books. A special type of KG has evolved that has made it possible for a limited company to be the unlimited partner without its shareholders assuming liability beyond their investment in that company (the 'GmbH and Co. KG'). This mixed form, which may have tax advantages, but is not always regarded favourably for commercial reasons, would be subject to special regulations under the proposed GmbH reform law.

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In a 'silent partnership' (*Stille Gesellschaft*), the owner of a business retains its property and is usually responsible for all its debts, but the 'silent partner' receives a share of its profits in return for contributing capital.

Partnerships do not have to publish their accounts unless they are large enterprises, as defined on page 91.

## Other Forms

The sole owner (*Einzelfirma*) who carries on business for the purpose of making profit is a 'merchant' subject to the Commercial Code, and is required to register in the Commercial Register. A sole owner, whether or not he is required to be registered, must use his own complete name in his trade and may in addition indicate the type of his business.

Civil law instead of commercial law associations are often used by companies or individuals for short term joint ventures or for unlimited projects. Examples of such civil law associations are: syndicates, profit pooling schemes, study groups, joint construction work, real estate administration, protection of property, or dealing on joint account. A contract between the members is the only requirement for setting up such an association; it must be submitted to the tax office. The tax law requires the keeping of books if sales, business property, or profits exceed certain limits. The comments on taxation, page 126, apply also to a foreign participator in such an association.

A foundation or trust (*Stiftung*) may be constituted by deed for charitable or family purposes. A registered association (*eingetragener Verein*) is another form sometimes used for those purposes, or as a vehicle for a company-run pension or welfare scheme.

Cooperative societies (*Genossenschaften*) are used in agriculture, trading, home-building, and consumer credit.





## CHAPTER VII

# Accounting and Auditing

- FORM OF FINANCIAL STATEMENTS
- ACCOUNTING PRINCIPLES AND PRACTICES
- AUDIT REQUIREMENTS AND PRACTICES

- THE ACCOUNTING AND AUDITING PROFESSION
- BOOKS AND RECORDS
- SPECIMEN STANDARD REPORTING FORMS

### FORM OF FINANCIAL STATEMENTS

#### Legal Requirements as to Layout and Content

German accounts clearly show the influence of extensive legal requirements on their form and content. Standard reporting formats must be followed by all AG corporations, and these are usually followed by GmbH companies and other bodies as well.

The Commercial Code lays down the basic rules for bookkeeping and balance sheet preparation. The Code is binding on all commercial enterprises, but is supplemented by special laws for AG corporations, GmbH companies, cooperative societies and others, and by tax law, which applies to all enterprises. Formal requirements for the use of standard reporting formats for the balance sheet and the profit and loss statement are not included in the Code, but only in the AG corporation law. These provisions are, however, generally accepted and voluntarily applied by commercial entities of other legal forms. Different form sheets are required by law for special categories of business, such as banks and other financial institutions, insurance companies, housing companies, and savings and loan associations. AG corporations, and other business entities of a certain size as required by the 1969 Publicity Law, must not only prepare but publish their financial statements in the prescribed AG corporation form.

Because of the extensive legal and tax requirements, the stock exchanges have had practically no influence on the form or content of financial statements. Accountants also have been less prominent than those of other countries in the development of financial information, although the professional accounting body issues opinions as appropriate, as for example on accounting problems arising when legal provisions do not meet the circumstances of a particular case.

**Accounts of AG Corporations.** The standard reporting format required by law for the balance sheet and profit and loss statement of an AG is set out on pages 106-111.

The standard format shows clearly the grouping and order to be adopted and the extent of the information required in the case of an ordinary AG. The balance sheet is in the double-side form, with assets

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on the left and capital and liabilities on the right. Real estate, plant, and equipment are followed by intangibles, investments, and current assets. On the right side, share capital is the first item, followed by shareholders' reserves, provisions, long-term liabilities, current liabilities, and unappropriated earnings.

The standard profit and loss account of a manufacturing business shows net sales, changes in inventories (except raw materials and supplies, shown in cost of items consumed), and the capitalised costs of self-constructed assets. The resulting output is the basic figure from which are deducted individual listed expenses. In a trading business, the net sales form this basic figure. Generally, debits and credits for unlike items may not be offset against each other.

By law, the headings shown must be followed unless the business concerned is of a specialised nature, as for example, a film producer, when other but equally informative forms or headings must be substituted. Additional headings may be used, however, to disclose the financial position adequately, and inapplicable headings may be omitted.

In addition, an AG corporation must prepare a management report (*Geschäftsbericht*) in two sections. The first deals with the general state of the corporation's business and financial position, including any substantial post-balance-sheet events, and the second consists of comments on the financial statements equivalent to the 'notes to financial statements' found in some other countries. In the second section, not only the composition of major items and their changes vis-à-vis the previous year are commented upon, but also additional information is given (for instance, changes in depreciation and valuation methods, which must be reported in figures if substantial, and the remuneration of both boards). Every subsidiary AG corporation has to prepare a second report showing how its results may have been adversely affected by its parent's actions (this is the 'dependency report' (*Abhängigkeitsbericht*) described in Chapter 6).

Consolidated statements dealing with German subsidiaries in which management is effectively exercised are required by the 1965 AG corporation law if the parent or one of its subsidiaries is an AG or a 'large enterprise' as defined on page 91.

**Accounts of Other Business Entities.** Although not required by law, it is the current practice of all other business entities to adopt the AG standard balance sheet format. The income statement format of such others is sometimes adjusted with regard to the peculiarities of their trades.

Entities that qualify as large enterprises must follow the AG corporation rules. Large enterprises are those that, for three years at least, meet two of the following criteria: balance sheet totals exceed DM 125 million; sales exceed DM 250 million; or employees exceed 5,000. For this purpose, all businesses controlled by the same enterprise are aggregated.

### **Publication Requirements**

The financial statements of an AG corporation and the auditors' opinion thereon, but not the informative management report, must be published in the Federal Gazette and in approved newspapers as required by the articles. In addition, the AG corporation has to file a copy of its financial statements, together with the auditors' opinion, the management report, and the minutes of the shareholders' meeting, with the Commercial Register. The notary who prepares the minutes normally files all these documents.

Every other large enterprise must publish its financial statements and auditors' opinion in the Federal Gazette and file a copy of these documents, together with the management report, with the Commercial Register. Large partnerships and sole traders, however, are not required to publish their income statements; instead, they must furnish additional information. They also need not prepare and issue management reports.

The financial statements of all other enterprises, including most GmbHs and branches of foreign organisations, are not required to be published, but the proposed GmbH reform law would require publication of financial statements whenever balance sheet totals exceed DM 4 million.

A wholly-owned and integrated subsidiary corporation is not required to publish its accounts if at its closing date consolidated accounts and reports of the parent are submitted to the Commercial Register.

In addition, an enterprise with an 'economic committee' (page 59) must disclose some financial information to the members of that committee.

## **ACCOUNTING PRINCIPLES AND PRACTICES**

### **General Principles**

The financial statements of any enterprise must disclose its financial standing and earnings as reliably as possible, insofar as the prescribed valuation rules allow, and must be clearly arranged to permit the reader

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to understand its position. The effect of these 'prescribed rules' is described later. Consistency in balance sheet preparation is required, which means conformity of figures in successive balance sheets and consistency of valuation methods applied. If an AG corporation changes to another valuation method allowed by law, the change must be commented upon in the management report. Any deviation resulting from a change of valuation methods exceeding 10% of the reported profit or loss for the year, or 0.5% of the nominal amount of the share capital, must be quoted in figures in the management report, so that readers of the statements may understand what happened in that year.

## Valuation Rules

Valuation rules, which have evolved from business economics and sound practices although influenced by tax law, are largely codified by the 1965 AG corporation law. This greatly affected German valuation and secret reserve practices; for example, fixed asset valuation must be based on systematic and not arbitrary depreciation policies.

Before the 1965 law, AG corporations were allowed considerable latitude in undervaluing assets, and other business entities followed similar practices. While the 1965 law allows AG corporations to adopt various alternative valuation bases, it does not permit biased valuations or excessive provisions. When value judgements are made, the principle of prudence allows all risks (for example, the possibility of litigation) to be considered, but this practice must not be mistaken for unjustifiably conservative accounting since the prescribed accounting rules are violated if unsubstantiated low values are adopted.

The starting point for the valuation of assets is cost; original cost can never be exceeded. For current assets, if market value is lower than cost, the lower value must be used; market value may be net realisable value or replacement cost, whichever is appropriate. Profits may not be recorded before they are realised, but unrealised losses must be provided for on the principle of prudence.

In addition to the cost or 'lower market' rule, however, the AG corporation law provides the following optional methods of valuation:

1. Lower valuation permissible for taxation purposes if incorporated in the accounts.
2. Retention of a lower valuation in consecutive balance sheets even if its reasons have ceased to exist.

Secret reserves may thus arise from these write-downs and, to a lesser extent, from changes in methods of valuation.

Business entities other than AG corporations and large enterprises are not bound by the AG corporation law. But the application of the valuation rules of this law is in accordance with the principles of proper accounting, and most other entities therefore follow those rules, especially as major undervaluations are not tax-deductible. As a result, secret reserves are probably less extensive than is often believed. Nonetheless, a reader must first ascertain whether financial statements have been prepared in accordance with AG corporation law principles.

These principles and rules give rise to practical points; they are described in the order used in the standard format.

## **Balance Sheet Practices**

**Property, Plant, and Equipment.** These are generally shown at net book value. Alternatively, cost is occasionally shown on the assets side of the balance sheet and accumulated depreciation on the liabilities side. Annual additions, deductions, transfers, and depreciation charges must be disclosed and analysed into major asset groups. Cost includes transportation, installation, and incidental expenses, and, in the case of land and buildings, associated taxes (page 152). Depreciation is required to be charged consistently over the useful life of the asset. Both straight-line and declining-balance methods are acceptable for depreciating plant and equipment, but normally only the former may be used for buildings. The law allows additional depreciation to be charged where there may have been a further decrease in value, as in the case of obsolescence.

Because depreciation is allowable for tax purposes only if charged in the accounts, any accelerated tax allowances claimed must be matched by equivalent charges in the financial statements. Small assets (at present, those costing DM 800 or less) may be fully depreciated in the year of purchase. Investment incentive grants received from federal sources are usually credited directly to the profit and loss account and not deducted from the cost of the assets concerned, but grants received from state sources are usually deducted from asset costs, for tax reasons.

Upward revaluations of property, plant, and equipment are permitted to correct past excessive depreciation. Past regular depreciation may only be adjusted to tax values, or in exceptional cases such as reorganisations or mergers. Real estate in particular may therefore have a market value considerably in excess of book value based on historical cost.

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**Intangibles.** These may be recorded only if acquired from others. Purchased goodwill and start-up costs must be written off over not more than five years. Organisational expenses such as formation costs must be expensed when incurred, and the same applies to research and development costs unless directly connected with a sales order.

**Investments.** Those held as long-term assets for trade reasons are carried at cost, but provision for loss is made if the loss is likely to have a lasting effect. Equity accounting is not permitted, because undistributed profits related to a minority shareholding are not deemed to be realised, but is required for the recording of partnership interests. The income for the current year of a subsidiary treated as 'controlled' may be entered in the parent's accounts as receivable for that year, unless the business year of the subsidiary ends at a later date than that of the parent. Securities considered to be held as current assets are carried at the lower of cost or net realisable value (item III-B7 of the assets section in the standard balance sheet on page 107).

**Long-Term Trade Accounts Receivable and Long-Term Loans Granted.** Any such assets that do not carry interest are discounted. The information to be disclosed is indicated in items II-B3 and III-B2 of the assets section of the standard balance sheet; the loans to be shown are those with an original term of at least four years, regardless of the amount actually outstanding at balance sheet date.

**Inventories.** These are generally valued at the lower of cost of acquisition or manufacture or market value (net realisable value or replacement cost as described below). 'Cost' is usually actual or average cost, as LIFO and FIFO methods are acceptable for tax purposes only if they correspond with the physical movement of goods. Cost of acquisition is the purchase price plus incidentals. Manufacturing cost comprises materials, labour, manufacturing overhead, and associated administrative expenses, but never selling expenses.

Inventory values may not exceed the realisable value net of final processing and selling expenses. Where a market price is not available, the 'value to be attributed' to the inventory applies if this is lower than cost. In arriving at this value, an expected price decrease in the near future may be anticipated. Furthermore, a lower value may be applied to the extent permitted for taxation purposes, as for example, that concerning certain imported raw materials.

In practice, when market values have fallen below cost, replacement cost is used for raw materials, and net realisable value for work-in-progress, finished goods, and excess materials or components.

**Prepaid Expenses.** These are payments made that constitute expenses for a definite period after the current accounting year. Deferred charges are not allowed.

**Equity Reserves (*Rücklagen*).** The legal reserve of an AG corporation must amount to at least 10% of share capital and may be higher if so required by its articles. In addition, the boards may appropriate up to 50% of the annual profit to free reserves, which are available to meet losses, or for increases of share capital from reserves in excess of the fixed amount of the legal reserve, or for dividends. As described in Chapter 6, GmbH companies and other entities need not provide a legal reserve; they may set up other reserves at the discretion of their members or as provided by their articles.

**Special Tax Reserves.** Although there is no heading for these in the standard balance sheet, they are normally introduced as a separate heading. These tax reserves are described in Chapter 8, but their accounting effect is summarised here. Normally, all such reserves defer income. The reserve for price increases of inventories need not be entered in the financial statements, but the amount of the deferred tax must be provided. If the reserve is included in the financial statements, the amount need not be disclosed separately. The special replacement reserve allows for a cost reduction of certain fixed assets and hence lower depreciation charges, and the reserve for investments in developing countries allows income to be deferred for five to eleven years. Movements on all these reserves must be commented upon in the management report, and the two latter reserves must be disclosed in the balance sheet.

**Allowances.** These are general provisions against assets. Accumulated depreciation of property, plant and equipment, or investments may be shown here, but is usually deducted from cost on the assets side of the balance sheet, so that the main 'allowance' here is any general provision against accounts receivable.

**Accrued Liabilities.** Although there is no legal obligation to do so, most enterprises include in their accounts a provision for future pension liabilities, calculated on an actuarial basis from current salary levels. (In addition, pensions paid in the year and estimated to be payable in the next five years must be quoted in a note.) Other items dealt with under this heading include provisions for uncertain payables, anticipated losses from pending transactions, and warranty expenditure incurred beyond legal obligations. With the exception of deferred maintenance

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work, which for tax reasons must be executed within the following three months, equalisation provisions, that is, provisions for expenses for which no liability yet exists, may not be accrued.

**Long-Term Borrowing for a Four-Year Minimum.** The period refers to the original period, regardless of the period actually outstanding at balance sheet date, although additionally the amounts due within the next four years are noted.

**Unappropriated Earnings.** This includes earnings retained from previous years and the unappropriated profit for the current year. The proposed dividend is not deducted from the unappropriated profit for the year, because such a dividend is subject to shareholders' approval after the date of the annual accounts. AG corporations may not pay an interim dividend before the accounting year-end. Sometimes, especially in the case of a large corporation, the unappropriated profit figure for the year is shown as the amount of the dividend proposed by the boards; the whole of the balance of the year's profit having been appropriated to reserves at the foot of the profit and loss account. Alternatively, the unappropriated profit may be shown as a round figure. In any case, the figure finally carried forward as 'unappropriated profit' into the next financial year is usually quite small, unlike the practice in some countries where transfers to reserves are not made and 'retained earnings' or 'unappropriated profits' grow to quite large figures.

## Taxation

The financial statements show the net income for the year after the charges for all taxes payable for the year. These include not only income taxes calculated on taxable income but also net worth tax and municipal trade tax as described in Chapter 8, and where applicable, foreign tax and prior years' tax adjustments. For corporation tax, different rates apply to the distribution of the dividend as proposed by the boards and to income retained. A surplus or deficit of the resulting tax charges compared with the payments on account made during the year is entered in 'other assets' or 'accrued liabilities' respectively. Substantial charges for prior years not covered by accruals should be described in the management report.

Normally, value added tax is not an expense item, and sales are shown net of this tax.

Because most taxation allowances are granted only if equivalent charges are made in the accounts, the main reason for setting up deferred taxation accounts does not apply. Certain reserves, as already described,



have the effect of deferring taxable income and thus comprise a mixture of shareholders' funds and deferred taxation. These are shown separately (Heading II-a in standard form), so that readers are aware that a deferred tax liability may exist.

## **Inflation Accounting**

The valuation rules in commercial and tax law are based on the principle of cost. The effects of inflation on the maintenance of capital cannot therefore be indicated in the financial statements, although an additional account may be given in the management report. Recently, the German professional body issued a recommendation for a simple calculation of income adjusted for inflation. Based on replacement values rather than current purchasing power adjustments, the additional depreciation required for fixed assets and other adjustments necessary to maintain capital (for example, inventory adjustments) should be disclosed.

## **Consolidation Rules**

An AG corporation or any other 'large enterprise' with a subsidiary in any legal form must prepare consolidated statements (*Konzernabschluss*) by law. A subsidiary for this purpose is one in which the parent owns more than 50% of the equity share capital and also exercises managerial control. Insignificant subsidiaries may be excluded. A subsidiary must not be consolidated if the information given in the consolidated statements would thereby be distorted; on the other hand, the consolidation of an affiliate in which less than 50% of its share capital is held is required, if this is necessary for a full understanding of the group's affairs.

Legally, foreign subsidiaries cannot be required to be consolidated; but if this is done, German valuation rules must be applied if the foreign subsidiaries' practices deviate substantially therefrom. A parent that is organised as a GmbH, if not a 'large enterprise,' is exempted from the preparation of consolidated statements, unless any one of its subsidiaries is an AG corporation. Consolidation is also required in a few other circumstances. In the case of German subsidiaries of a foreign parent, consolidation can be avoided by the publication of the foreign parent's audited consolidated statements in the Federal Gazette.

The consolidated statements generally follow the standard form sheets required by the AG corporation law, with the addition of figures for outside or minority stockholders' interests and differences arising on consolidation between the cost of investments and the proportionate

# Accounting and Auditing

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net assets acquired. The mechanics of a German consolidation differ from those found in many other countries. No distinction is normally made between pre-acquisition and post-acquisition reserves, the differences arising on consolidation being recomputed each year. However, any variation in these differences must be explained in the management report.

The assets and liabilities as shown in the individual balance sheets of the subsidiaries are consolidated. No special valuation rules are provided for consolidation. Profits and losses are normally aggregated from the date when new subsidiaries are acquired. Comments on group accounting practices are usually included in the management report (*Konzern-geschäftsbericht*). Furthermore, this report shows a list of all consolidated and non-consolidated companies. The reason for not consolidating any subsidiaries must be given; and if material, the financial statements of the non-consolidated companies must be attached to the consolidation report.

If group companies' accounting dates differ, subsidiaries' interim financial statements must be used for consolidation. Profits from inter-company transactions and supplies are eliminated.

## Merger Accounting

Mergers are treated as a purchase by one company of another, even where a new company is formed to take over existing ones. Such mergers must be by exchange of shares, and formal liquidation of the transferor company is not required. However, within certain limits, cash payments are permitted; and where a majority interest is already held, the balance can be purchased for cash.

The acquisition cost to the transferee is usually, for taxation reasons, the book value of the assets acquired in the closing balance sheet of the transferor, but market value may also be applied. Any credit difference arising is added to the legal reserve, while a debit difference must normally be amortised over not more than five years, or at once if a majority was held before the merger. Other amalgamations involving entities of differing corporate types, or resulting in any changes in corporate status, are described as 'reorganisations' (*Umwandlungen*) and are discussed in Chapter 8.

## Other Matters

**Profit and Loss Statements.** Movements in reserves, allowances, and accrued liabilities must be shown separately in the profit and loss ac-

count and may not be netted against other items. Transfers in accordance with profit and loss pooling contracts must similarly be indicated.

The remuneration of the management and supervisory boards is not shown separately in the profit and loss account but must be disclosed in total in the management report.

**Other Balance Sheet Points.** Shareholders' equity is not shown as such; registered capital and reserves being grouped at the head of the 'liabilities' side of the balance sheet, with unappropriated earnings shown as the last item on that side without any reference to proposed dividends. Share capital not paid in (even if the unpaid amount has not yet been demanded from shareholders) is shown as the first item in the assets section.

An accumulated deficit is shown as the last item on the assets side. Comparative figures are usually given at least by AG corporations. Capital commitments and post-balance-sheet events are usually disclosed in the management report. Contingent liabilities are described in the management report, and certain types must also be noted at the foot of the balance sheet.

## AUDIT REQUIREMENTS AND PRACTICES

### Legal Requirements for Audit

Accounts of all AG corporations must be audited by registered independent accountants (*Wirtschaftsprüfer* or *WP*). So too must those of the other 'large enterprises' defined on page 91, and banks, insurance companies, housing loan companies, and some other specialised enterprises, whatever their size or legal form. Other bodies, including the majority of GmbH companies, are not yet required by law to have an independent auditor (*Abschlußprüfer*), although many employ one.

The balance sheet, income or profit and loss statement, and the management report must be audited; also, where appropriate, the report on the financial effect of relationships with affiliated bodies. Further legal requirements concern investment funds and other specialised bodies, companies going into liquidation, mergers, and capitalisation issues, and the formation procedures mentioned on page 69. Foreign auditors with qualifications equivalent to those of a WP are accepted for the publication in Germany of a foreign parent's consolidated statements dealing with German subsidiaries.

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The AG corporation law is also the basis for any other obligatory or voluntary audit as laid down in the auditing guidelines of the professional institute to be followed by its members.

## Audit Standards

The AG corporation law of 1965 requires German auditors to ensure that the bookkeeping, financial statements, and management report comply with the relevant law and the corporation's articles. Reference to the law means that it is the purpose of the audit to establish that the financial statements disclose the corporation's financial standing and earnings as reliably as possible, insofar as allowed by the valuation rules, and to ensure that they are clearly arranged so as to enable the reader to understand the corporation's position. The valuation of balance sheet items is therefore considered a primary requirement for proper auditing.

The system of internal control is reviewed to determine the requirements, procedures, and scope of the audit. The independent confirmation of debtors depends on the results of this review. Attendance at stock-taking and other independent confirmation procedures are gaining ground. Management is responsible for the completeness of the accounts, and the auditors normally obtain a letter of representation (*Vollständigkeitserklärung*) containing a declaration that all relevant facts and documents have been disclosed to the auditors.

Although an investigation of fraudulent actions or falsifications would require a special audit engagement and is beyond the scope of the regular audit, the auditor must disclose any irregularities of which he became aware during the performance of his regular work. In the report on consolidated accounts, it is customary for the parent auditor to accept the reports of subsidiaries' auditors, if the latter are WPs, without further examination. The scope of audit engagements for foreign-owned subsidiaries is usually arranged by agreement with the parent company's auditor. A special feature is the attention the auditor must give to the management report that must accompany the annual balance sheet and profit and loss account of an AG. The financial section of this report must be examined and covered by the audit opinion. The general section is also subject to review by the auditor, who must satisfy himself that it does not contain misleading statements.

It is customary for the auditor to send to his client, at the beginning of each assignment, a statement setting forth the terms of the engagement in a standard form recommended by the German professional institute. Such a statement defines the scope of the engagement, independence rules, responsibilities of client and auditor, and similar matters.

There are no legal requirements concerning duties or the report of an auditor of a large GmbH or any other legal form of enterprise required to employ an independent auditor, but professional practice is similar to that for an AG. The professional institute has produced 'auditing guidelines' for all types of audit which its members are required to follow.

## **Audit Reports**

The long German report (*Prüfungsbericht*) is addressed to the management and supervisory boards, and is used by the latter in its assessment of the work of the former. The report must deal with the legal and commercial positions of the enterprise, analyse the financial and earnings situation by supplying condensed comparative statements, comment on bookkeeping methods, and include a summary of the result of the auditors' examination and their opinion. In a second section, details of the composition and movements in the accounts must be given. Facts that endanger the existence or affect the development of the enterprise, as well as any substantial violations by management of the law or the articles, must be reported. As a result, the report is often thirty pages or more long. The report must also comment on the management boards' statements about intercompany transactions with dependent companies. Consolidated accounts must be covered by the auditors in a second report.

The wording used for the 'opinion paragraph' (*Bestätigungsvermerk*) is normally that required by the AG corporation law: 'According to our audit, made in conformity with our professional duties, the accounting, the annual financial statements, and the report of the board of management comply with German law and the company's statutes.' The auditors are not required to state whether the accounts, supplemented by the management report, give a fair view of results and financial position, nor need they mention consistency of valuations, because these matters are considered to be dealt with in the law.

Except for the opinion paragraph, the audit report is not released to shareholders, although it is often disclosed to bankers who have made loans to the corporation.

## **Appointments and Changes of Auditors**

The auditors of an AG are appointed at the shareholders' meeting, except for the first auditors who are appointed by the supervisory board. If the shareholders fail to appoint an auditor at the meeting or if the auditor for some reason is unable to act, either the management or the supervisory board or any shareholder may request the court to appoint an auditor.

# Accounting and Auditing

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Shareholders have various rights to request special audits. For example, holders of shares of at least DM 1 million or 5% of the share capital may ask the court to order a special investigation in cases of suspected material understatements of assets and profits in the financial statements. Furthermore, any shareholder may request the court to appoint a special auditor if the corporation has been put to some disadvantage by its parent without adequate compensation, or if the dependency report has been qualified. The special auditor must be given access not only to the books of the corporation concerned but also to those of its parent.

If the financial statements of a GmbH company or other entity are audited, much the same rules apply as for an AG, the appointment of the auditor being initially in the hands of the members or managing partners.

## THE ACCOUNTING AND AUDITING PROFESSION

### The National Accounting Profession

The German professional auditing organisations are the Chamber of Auditors (*Wirtschaftsprüferkammer*), which has judicial powers to supervise professional activities, and the Institute of Auditors (*Institut der Wirtschaftsprüfer*), which is concerned with ethical questions and technical matters such as the promulgation of accounting principles and the interpretation and application of legal provisions. Membership in the Chamber is required by law, but membership in the Institute is optional. As these bodies are concerned only with auditors, accountants employed in industry or commerce may neither practice nor describe themselves as *Wirtschaftsprüfer*. A former WP returning to audit practice after a period in industry may even have to take some of the professional examinations again.

Members must be German nationals or foreigners who obtain their WP qualification in Germany and non-WPs who become management board members of incorporated accounting firms. Foreign qualified accountants may become management board members of accounting firms and must join the Chamber (but not the Institute) if they are from countries that grant reciprocal practice rights to German accountants. WPs may practise alone or they may establish an accounting firm in any legal form. If, for example, an AG corporation is formed, the independence of the individual accountant employed must be preserved; the shares must be registered and held by WPs; and the management board

must normally be composed of such persons or of qualified tax consultants. WPs may act as management consultants subject to the professional rules which follow.

A consultant who works exclusively in the tax field is known as a *Steuerberater* (tax consultant). Qualification rules are similar to those for auditors, but with more emphasis on taxation, and members have a separate professional organisation. A *Steuerberater* is not allowed to audit the accounts of an AG.

The German accounting profession is represented on the study-group set up by the European accountancy bodies to advise the EEC Commission on accounting and related matters, and is one of the founder-members of the International Accounting Standards Committee.

## Training and Qualifications

A prospective *Wirtschaftsprüfer* is required to graduate from a university in law, economics, and business, and to obtain five years' practical experience in business including at least four years in the accounting profession. He must then pass a written and oral examination in accounting and business matters, commercial and tax law, auditing practice, and professional ethics. Few candidates qualify before the age of 35.

Perhaps because of the stringent membership and qualification requirements, there are only about 3,200 members of the Chamber. Despite this small number, however, there are several large accounting firms, most of which have international connections. There are many more tax consultants than qualified auditors.

## Professional Rules

Independence, impartiality, conscientiousness, responsibility, and confidentiality must all be observed by every *Wirtschaftsprüfer*. Professional behaviour includes the strict prohibition of promotional advertising. Independence rules bar an auditor from having any material investment or interest in a client company, being an employee or member of its management or supervisory boards, or having any participation in its management. An auditor must not prepare the financial statements on which he is to give an opinion, although professional accounting assistance to the client and occasional bookkeeping services are allowed.

An auditor's liability for negligence suffered by his AG client is limited by the AG corporation law to DM 500,000, and the general terms that

# Accounting and Auditing

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auditors of other bodies arrange each year with their clients provide for this limit also. Liability to third parties is rare. Fees for audits required by law are based on a combination of time spent and charges based on balance sheet totals, but fees for other work are based on time spent only.

## BOOKS AND RECORDS

### Legal Requirements

The Commercial Code provides that the managers of every business (whether corporation, branch, or other form) shall be responsible for the keeping of proper records. These need not be in the German language, but as they will be subject to periodic examination by government tax auditors, it is helpful if German is used. For the same reason, all records and vouchers should be kept in Germany.

Bookkeeping standards have been established by the Commercial Code of 1897 (currently being revised), indirectly by tax law, and by generally accepted accounting standards. These require up-to-date double-entry bookkeeping records, physical stock-taking, the maintenance of fixed asset records, and the preparation of annual accounts. Retention periods for books, vouchers, and correspondence are also prescribed by law. If microfilms are used, these also must be retained in accordance with the law. Alterations and erasures in records are forbidden. Generally, the standard of record-keeping and document filing is very high throughout the business community. Loose-leaf and voucher-record forms of accounting and computer-produced records are permissible if rules as to printouts, audit trails, and retention of documents in Germany are complied with.

### Management Accounts

Interim accounts for management for monthly, quarterly, or six-month periods are often prepared, with or without the assistance of outside accountants. Managers and controllers generally have experience in interim accounting, cost accounting, and price calculation, Germany having been a pioneer in the development of cost accounting between the two World Wars.



**SPECIMEN STANDARD REPORTING FORMS  
(pages 106-111)**

## SPECIMEN STANDARD REPORTING FORM – BALANCE SHEET

BILANZ		BALANCE SHEET	
<b>Aktiva</b>		<b>Assets</b>	
I Ausstehende Einlagen auf das Grundkapital; davon eingefordert _____		I Share capital not yet paid in; amount due from shareholders _____	
II Anlagevermögen:		II Fixed assets:	
A Sachanlagen und immaterielle Anlagewerte:		A Property, plant and equipment, intangible assets:	
1 Grundstücke und grundstücksgleiche Rechte mit Geschäfts-, Fabrik- und anderen Bauten		1 Land and equivalent rights with office, factory and other buildings erected on such land	
2 Grundstücke und grundstücksgleiche Rechte mit Wohnbauten		2 Land and equivalent rights with dwelling structures erected on such land	
3 Grundstücke und grundstücksgleiche Rechte ohne Bauten		3 Land and equivalent rights without buildings erected on such land	
4 Bauten auf fremden Grundstücken, die nicht zu Nummer 1 oder 2 gehören		4 Buildings erected on leasehold land not included in Nos. 1 and 2	
5 Maschinen und maschinelle Anlagen		5 Machinery and installations	
6 Betriebs- und Geschäftsausstattung		6 Factory and office equipment	
7 Anlagen in Bau und Anzahlungen auf Anlagen		7 Construction in progress and advances paid for construction work (advances to suppliers relating to fixed assets would also be shown here)	
8 Konzessionen, gewerbliche Schutzrechte und ähnliche Rechte sowie Lizenzen an solchen Rechten		8 Intangible assets (franchises, patents, copyrights, trademarks, licences, etc.)	
B Finanzanlagen:		B Financial Assets:	
1 Beteiligungen		1 Investments (participations)	
2 Wertpapiere des Anlagevermögens, die nicht zu Nummer 1 gehören		2 Securities held for investment purposes which are not included in No. 1	
3 Ausleihungen mit einer Laufzeit von mindestens vier Jahren; davon durch Grundpfandrechte gesichert _____		3 Loans granted for at least four years; amount of such loans secured by mortgages _____	

### III Umlaufvermögen:

#### A Vorräte:

- 1 Roh-, Hilfs- und Betriebsstoffe
- 2 unfertige Erzeugnisse
- 3 fertige Erzeugnisse, Waren

#### B Andere Gegenstände des Umlaufvermögens:

- 1 geleistete Anzahlungen, soweit sie nicht zu II A Nummer 7 gehören
- 2 Forderungen aus Lieferungen und Leistungen; davon mit einer Restlaufzeit von mehr als einem Jahr \_\_\_\_\_
- 3 Wechsel;  
davon bundesbankfähig \_\_\_\_\_

#### 4 Schecks

#### 5 Kassenbestand, Bundesbank- und Postscheckguthaben

#### 6 Guthaben bei Kreditinstituten

#### 7 Wertpapiere, die nicht zu Nummer 3, 4, 8 oder 9 oder zu II B gehören

#### 8 eigene Aktien unter Angabe ihres Nennbetrages

#### 9 Anteile an einer herrschenden oder an der Gesellschaft mit Mehrheit beteiligten Kapitalgesellschaft oder bergrechtlichen Gewerkschaft unter Angabe ihres Nennbetrages, bei Kuxen ihrer Zahl

#### 10 Forderungen an verbundene Unternehmen

- 11 Forderungen aus Krediten, die
  - a) unter § 89
  - b) unter § 115 fallen
- 12 sonstige Vermögensgegenstände

### IV Rechnungsabgrenzungsposten

### V Bilanzverlust

### III Current assets:

#### A Inventories:

- 1 Raw materials and supplies
- 2 Work in progress
- 3 Finished products, merchandise

#### B Other current assets:

- 1 Advances other than paid for construction work (II A No. 7)
- 2 Trade accounts receivable; amount of such receivables due in more than one year \_\_\_\_\_
- 3 Notes receivable and bills of exchange (trade acceptances); those acceptable for discount by Bundesbank \_\_\_\_\_

#### 4 Cheques

#### 5 Cash on hand and deposits with Bundesbank and postal cheque office.

#### 6 Deposit with banks

#### 7 Securities not classified under Nos. 3, 4, 8, or 9 nor under II B

#### 8 Holding of own shares (note their nominal amount)

#### 9 Shares of a controlling corporation or of a corporation holding the majority (note their nominal amount). Shares of a controlling mining association or of a mining association holding the majority (note their number).

#### 10 Accounts receivable, due from affiliated enterprises

- 11 Accounts receivable, due from
  - a) members of the board of management
  - b) members of the supervisory board
- 12 Other assets

### IV Prepaid expenses

### V Accumulated deficit

(continued)

# Accounting and Auditing

## BILANZ (fortgesetzt)

### Passiva

- I Grundkapital
- II Offene Rücklagen:
  - 1 Gesetzliche Rücklage
  - 2 Andere Rücklagen (freie Rücklagen)
- \*IIa Sonderposten mit Rücklageanteil

## BALANCE SHEET (continued)

### Liabilities and capital

- I Share capital
- II Equity reserves:
  - 1 Legal reserve
  - 2 Other reserves (free reserves)
- \*IIa Special caption for reserves containing a deferred tax element  
(this refers to income-deferring reserves that will be subject to income taxation when released at some future time)

### III Wertberichtigungen

- IV Rückstellungen:
  - 1 Pensionsrückstellungen
  - 2 Andere Rückstellungen

### III Allowances

- IV Accrued liabilities:
  - 1 Pension reserves
  - 2 Other accrued liabilities

### V Verbindlichkeiten mit einer Laufzeit von mindestens vier Jahren:

- 1 Anleihen;  
davon durch Grundpfandrechte gesichert \_\_\_\_\_
- 2 Verbindlichkeiten gegenüber Kreditinstituten; davon  
durch Grundpfandrechte gesichert \_\_\_\_\_
- 3 sonstige Verbindlichkeiten;  
davon durch Grundpfandrechte gesichert \_\_\_\_\_  
Von Nummer 1 bis 3 sind vor Ablauf von vier Jahren  
fällig \_\_\_\_\_

### V Long-term borrowings for at least four years:

- 1 Loans (secured by mortgage \_\_\_\_\_)
  - 2 Bank loans (secured by mortgage \_\_\_\_\_)
  - 3 Other liabilities (secured by mortgage \_\_\_\_\_)
- Amount of Nos. 1, 2 and 3 due before expiration  
of four years \_\_\_\_\_

\* Not provided for in the basic standard form.

<b>VI</b>	<b>Andere Verbindlichkeiten:</b>	<b>VI</b>	<b>Other liabilities:</b>
1	Verbindlichkeiten aus Lieferungen und Leistungen	1	Trade accounts payable
2	Verbindlichkeiten aus der Annahme gezogener Wechsel und der Ausstellung eigener Wechsel	2	Liabilities from acceptances and of promissory notes issued
3	Verbindlichkeiten gegenüber Kreditinstituten, soweit sie nicht zu V gehören	3	Bank loans and overdrafts—liabilities apart from those of V
4	erhaltene Anzahlungen	4	Advances received
5	Verbindlichkeiten gegenüber verbundenen Unternehmen	5	Accounts payable, due to affiliated enterprises
6	sonstige Verbindlichkeiten	6	Accounts payable, other
<b>VII</b>	<b>Rechnungsabgrenzungsposten</b>	<b>VII</b>	<b>Deferred Income</b>
<b>VIII</b>	<b>Bilanzgewinn</b>	<b>VIII</b>	<b>Unappropriated earnings</b>

# Accounting and Auditing

## SPECIMEN STANDARD REPORTING FORM – PROFIT AND LOSS STATEMENT

<i>GEWINN-UND VERLUSTRECHNUNG</i>		<i>PROFIT AND LOSS ACCOUNT</i>
1 Umsatzerlöse	1 Net sales	
2 Erhöhung oder Verminderung des Bestandes an fertigen und unfertigen Erzeugnissen	2 Increase or decrease of inventories of finished products and work in progress	
3 andere aktivierte Eigenleistungen	3 Capitalized costs of assets constructed	
4 Gesamtleistung	4 Total output	
5 Aufwendungen für Roh-, Hilfs- und Betriebsstoffe sowie für bezogene Waren	5 Cost of raw material, supplies and purchased goods	
6 Rohertag/Rohaufwand	6 Gross operating profit or loss	
7 Erträge aus Gewinngemeinschaften, Gewinnabführungs- und Teilgewinnabführungsverträgen	7 Income from profit pools and profit and loss pooling contracts relating to whole or partial transfer of profit or (loss)	
8 Erträge aus Beteiligungen	8 Income from investments	
9 Erträge aus den anderen Finanzanlagen	9 Income from other financial assets	
10 sonstige Zinsen und ähnliche Erträge	10 Other interest earned and similar income	
11 Erträge aus dem Abgang von Gegenständen des Anlagevermögens und aus Zuschreibungen zu Gegenständen des Anlagevermögens	11 Income from disposals of fixed assets and from appreciation of fixed assets	
12 Erträge aus der Herabsetzung der Pauschalwertberichtigung zu Forderungen	12 Income from a decrease of the global allowance for doubtful accounts receivable	
13 Erträge aus der Auflösung von Rückstellungen	13 Income from provisions no longer required	
14 sonstige Erträge; davon außerordentliche _____	14 Other income; non-recurrent _____	
15 Erträge aus Verlustübernahme	15 Income resulting from loss transferred to contracting party in a profit and loss pooling contract	
16 Löhne und Gehälter	16 Wages and salaries	
17 soziale Abgaben	17 Social security charges	
18 Aufwendungen für Altersversorgung und Unterstützungen	18 Old age relief and social aid expenses	

19	Abschreibungen und Wertberichtigungen auf Sachanlagen und immaterielle Anlagewerte	19	Depreciation/amortization of property, plant and equipment and intangible assets
20	Abschreibungen und Wertberichtigungen auf Finanzanlagen mit Ausnahme des Betrages, der in die Pauschalwertberichtigung zu Forderungen eingestellt ist.	20	Write-down and adjustment of financial assets excepting the amount added to the global allowance for doubtful accounts receivable
21	Verluste aus Wertminderungen oder dem Abgang von Gegenständen des Umlaufvermögens außer Vorräten (§ 151 Abs. 1 Aktivseite III B) und Einstellung in die Pauschalwertberichtigung zu Forderungen	21	Losses from the decrease in value or the disposal of current assets except inventories (assets III B) and additions to the global allowance for doubtful accounts receivable
22	Verluste aus dem Abgang von Gegenständen des Anlagevermögens	22	Losses on disposals of fixed assets
23	Zinsen und ähnliche Aufwendungen	23	Interest and similar expenses
24	Steuern	24	Taxes
	a) vom Einkommen, vom Ertrag und vom Vermögen		a) on income, earnings and net worth
	b) sonstige		b) other
25	Aufwendungen aus Verlustübernahme	25	Losses assumed according to profit and loss pooling contracts
26	sonstige Aufwendungen	26	Other expenses
27	auf Grund einer Gewinngemeinschaft, eines Gewinnabführungs- und eines Teilgewinnabführungsvertrags abgeführte Gewinne	27	Profits transferred in accordance with profit pools and profit and loss pooling contracts relating to whole or partial transfer of profit or (loss)
28	Jahresüberschuß Jahresfehlbetrag	28	Profit/loss for the year
29	Gewinnvortrag/Verlustvortrag aus dem Vorjahr	29	Profit/loss retained from previous year
30	Entnahmen aus offenen Rücklagen	30	Reduction of reserves
	a) aus der gesetzlichen Rücklage		a) legal reserve
	b) aus freien Rücklagen		b) free reserves
31	Einstellungen aus dem Jahresüberschuß in offene Rücklagen	31	Appropriation of profit for the year to reserves
	a) in die gesetzliche Rücklage		a) to legal reserve
	b) in freie Rücklagen		b) to free reserves
32	Bilanzgewinn/Bilanzverlust	32	Unappropriated earnings/accumulated deficit



## CHAPTER VIII

# Taxation in Germany

- INTRODUCTION
- CORPORATE TAXATION
- CORPORATIONS RESIDENT IN GERMANY
- TAXABLE PROFITS
- ALLOWABLE DEDUCTIONS
- TREATMENT OF GROUPS AND LOSSES
- TAX TREATMENT OF INCENTIVES
- CORPORATIONS NOT RESIDENT IN GERMANY
- REORGANISATIONS AND LIQUIDATIONS
- RATES OF CORPORATION TAX
- TAX RETURNS – FILING, ASSESSMENT AND AUDITS
- TAXATION OF INDIVIDUALS
- RESIDENCE AND NONRESIDENCE
- TAXABLE INCOME
- ALLOWABLE DEDUCTIONS AND PERSONAL RELIEFS
- RATES OF INCOME TAX
- CHURCH TAX
- WAGE TAX
- RETURNS AND ASSESSMENTS
- FOREIGN TAX LAW
- TAXATION OF OTHER ENTITIES
- WITHHOLDING TAXES
- DOUBLE TAXATION AGREEMENTS
- VALUE ADDED TAX
- MUNICIPAL TRADE TAX
- NET WORTH TAX
- MISCELLANEOUS TAXES
- COMPARATIVE TABLES

### INTRODUCTION

Taxes are levied by the Federal Government, the individual states and the local authorities.

The principal taxes are:

1. Income and corporation tax (*Einkommensteuer, Körperschaftsteuer*)
2. Value added tax (*Mehrwertsteuer*)
3. Municipal trade tax (*Gewerbesteuer*)
4. Net worth tax (*Vermögensteuer*)
5. Inheritance and gift tax (*Erbschaftsteuer, Schenkungsteuer*)
6. Withholding taxes on dividends and similar payments (*Kapitalertragsteuer*).

There are also taxes on transfers of real estate and other property and on contributions to capital, and stamp duties on certain documents. In addition, based on a resident individual's income tax liability, a church tax is payable through the local tax office to recognised religious bodies. Customs duties have been described in Chapter 3.

### Sources of Legislation

The constitution of the Federal Republic places responsibility for tax laws on the federal authorities. At the time this business study was written, basic laws were contained in the Fiscal Code (*Abgabenord-*



# Taxation in Germany

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nung, or AO) and the Law for the Adaptation of Taxes (*Steueranpassungsgesetz* or *StAnpG*). From 1st January 1977, these two laws will be consolidated into an amended Fiscal Code. Specific taxes are governed by individual laws. These laws are supplemented by ordinances, having the force of law, and comprehensive administrative regulations promulgated by the Federal Ministry of Finance (*Bundesfinanzministerium*). In addition, decrees and circulars are issued by various bodies; for example, the federal and state Ministries of Finance and regional finance offices. Lastly, decisions of the state tax courts and the Federal Supreme Tax Court in Munich provide important sources for the definition and interpretation of tax law.

## Reform of Tax Law

For some years, the Federal Government has been engaged in a programme of tax reform. This has resulted in new laws on net worth, real property, inheritance and gift taxes, effective from 1st January 1974. These were necessary to recognise current values of real property that are substantially higher than those in use before the reform, which were based on 1935 values, reassessed in 1964. Similarly, the reformed income tax law relating to individuals came into force on 1st January 1975; this now favours low-income earners. The Foreign Tax Law (page 142) dealing with certain aspects of tax avoidance and attribution of the income of foreign companies to residents came into effect on 12th September 1972. In 1976 the corporation tax law was reformed with effect from 1st January 1977. This chapter has therefore been written taking into consideration the corporation tax reform law, although references are made to the former law as deemed appropriate.

## Definition of Territory

German tax laws apply in the area of the Federal Republic of Germany, which consists of the ten states described in Chapter 1 together with its territorial sea and share of the Continental Shelf. The authority of the laws is also extended to West Berlin, where special tax privileges, dealt with in Chapter 9, are available.

## Administration of Tax Laws

The Federal Ministry of Finance is responsible for tax administration and the drafting of tax laws for federal and state authorities. Taxes are assessed and collected by the appropriate local tax office (*Finanzamt*), which is under the control of the regional state tax office. The revenues produced by both personal and corporate income taxes and value added tax are shared between the federal and state governments. Similarly, the states and municipalities share revenue from trade and wage taxes. Municipal taxes are administered by the relevant municipalities.

## CORPORATE TAXATION

Corporate bodies are subject to corporation tax (*Körperschaftsteuer*) in accordance with the Corporate Income Tax Law, which is an addendum to the Income Tax Law. 'Corporate bodies' in this context means AGs, GmbHs, KGaAs, cooperatives, mutual insurance societies, and comparable foreign entities. Corporation tax may also apply to foundations broadly comparable to trusts under Anglo-American law. In this chapter, the term 'corporation' includes all these entities except where the context requires otherwise. General and limited partnerships (OHGs and KGs) are not taxable entities for corporation tax purposes (page 144).

A resident corporation is liable to corporation tax on all income from both domestic and foreign sources, whereas a nonresident corporation is liable only on its income from German sources.

There are no special rules for 'close' corporations, that is, those controlled by a small number of individuals, to ensure distributions of profit to members, as are found in, for instance, Japan, the United Kingdom and the USA.

### CORPORATIONS RESIDENT IN GERMANY

A corporation is considered resident in Germany or West Berlin if its legal seat or place of management is there. The legal seat of a corporation organised under Federal Law must be in Germany or West Berlin, and therefore all such corporations are considered resident for the purposes of corporation tax by the German tax authorities. The 'place of management' means the office from which the activities of the corporation are directed. Under some double taxation agreements, if the place of management of a German corporation is situated in the other treaty country, then it is considered to be resident in that other country and not in Germany. However, because the German tax authorities feel that the legal seat of a corporation determines its place of management, it is improbable that a German-registered corporation will be accepted as being nonresident by the tax authorities.

A corporation incorporated under a foreign law will become taxable in Germany on its income if its place of management is in the Federal Republic, and no relief from this rule is available under any double taxation agreements. The opening of a branch will not expose a foreign corporation to corporation tax on non-German income, provided its head office, and therefore place of management, remains outside Germany.

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## TAXABLE PROFITS

For corporation tax purposes, a corporation's whole income is deemed to arise from the profits of its business or trade, in contrast with the personal income tax system where chargeable income is divided into seven different categories.

### General Rules

Profit or loss is computed by reference to the increase or decrease in the corporation's net worth during the year as shown by a comparison of its opening and closing balance sheets. Commercial law rules are generally used in preparing financial statements. Since taxable income is directly affected by the valuation of assets and liabilities, the income tax law contains detailed and mandatory valuation rules. A separate balance sheet and income statement must therefore be prepared for tax purposes unless the official accounts comply with tax law.

### Valuation of Inventory

Inventories, like all current assets, must be valued at the lower of cost or market value, usually defined as net realisable value. Each item must be considered individually for this purpose. In certain circumstances weighted average prices for calculating cost may be taken. The first-in, first-out and the last-in, first-out methods of inventory valuation are generally unacceptable for tax purposes, unless the taxpayer can demonstrate the particular suitability of either of these methods in the circumstances of his business. Normally, inventory valuation for tax purposes is identical with that in the official accounts. Deductions allowable under the tax law may be deducted only if they are made in the official accounts; the one exception is a reserve for price increases, which need not be disclosed in the official accounts, but is nonetheless deductible for tax purposes (page 122).

### Capital Gains

Corporations' capital gains are treated as ordinary business income and are taxed at normal rates, whereas capital losses are fully deductible. A capital gain or loss occurs only on the disposal of an asset. Tax on the gains on sale of certain fixed assets that are replaced may however be deferred, by transferring the gains to a replacement reserve (page 123).

### Dividends from Resident Corporations

Dividends received from resident corporations normally form part of the recipient's income for corporation tax purposes. Corporations paying dividends must deduct the withholding tax of 25% (the capital

yields tax described on page 144) from dividends paid to resident and nonresident shareholders alike. This withholding tax is credited against the corporation tax liability of the recipient resident corporation or of the recipient branch of a nonresident corporation if the participation is attributable to that branch. In addition, under the terms of the corporation tax reform law, a corporation receiving a dividend from a distributing corporation for a financial year ending after 31st December 1976, also has imputed to it a credit for the corporation tax paid by the distributing corporation. This credit is not available to nonresident corporations (nor to their German branches, if any), mutual insurance associations and business operations of public legal entities (for example, state banks). This imputation system is illustrated by the following example:

	DM
Net cash received by shareholding corporation	4,800
Withholding tax (capital yields tax):	
DM 4,800 $\times \frac{25}{75}$ (Note 1)	<u>1,600</u>
	6,400
Imputed corporation tax:	
DM 6,400 $\times \frac{36}{64}$ (Note 2)	<u>3,600</u>
Total income reported for corporation tax purposes	<u>10,000</u>
Tax credits available for offset or repayment (DM 1,600 + 3,600)	5,200

- Notes:
1. Since the rate of withholding tax is 25%, to arrive at the dividend paid a grossing factor of  $25 \div (100 - 25)$  is necessary.
  2. Since the rate of corporate income tax is 36%, the grossing factor is  $36 \div (100 - 36)$ .

Before the introduction of the corporate tax reform law, no credit was given for underlying corporate taxation, although the privilege described next would have applied.

### **Affiliated Privilege (*Schachtelprivileg*)**

Special provisions existed whereby dividends received before 1st January 1977 by one corporation from another were not taxable in the hands of the recipient. These provisions arose from the tax concept of exempting income already taxed in another corporation. To obtain this privilege, the following conditions had to be met:

1. Both paying and receiving corporations were German residents, and

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2. 25% or more of the share capital of the payer had been held by the recipient for at least 12 months before the latter's balance sheet date.

However, the recipient was subject to a supplementary tax (*Nachsteuer*) of 36% on the dividend unless it was redistributed to its own shareholders. The recipient had first to distribute its own trading profit for the year before the redistribution of dividend income was recognised.

The 'affiliated privilege' rule remains of importance even after the corporation tax reform, because it also applies to municipal trade tax and net worth tax (pages 149-150).

## **Dividends from Nonresident Corporations**

The method of taxation of dividends from nonresident corporations depends on whether a double taxation agreement is in existence and the form of that agreement. If there is no agreement, a system exists that gives unilateral double tax relief as follows:

**Credit for Underlying Foreign Taxes.** On application, a resident corporation that owns 25% or more of the share capital of a foreign corporation can claim a credit for the proportionate amount of income taxes paid by the foreign corporation on the profits underlying the dividend, if those foreign taxes are deemed to correspond to German corporation tax. When calculating the credit available for the foreign taxes, the income of the foreign corporation is determined according to the provisions of German commercial law and the credit is limited to the proportionate amount of the German corporation tax calculated at the average rate on the recipient's taxable income for the year.

**Credit for Foreign Withholding Taxes.** Whatever percentage of shares is held, credit is given for withholding taxes suffered.

This system usually applies for situations in which a double taxation agreement exists, except that the rate of the withholding would generally be reduced and the international affiliated privilege described next might apply.

**International Affiliated Privilege.** The 'affiliated privilege' rule has been extended by many double taxation agreements to dividends received from associated or affiliated corporations located in foreign countries. Thus, a tax exemption is granted in Germany whereby a corporation there obtains all the advantages resulting from any lower taxation in the foreign country, except that the excluded amounts are taken into ac-

count in computing the German tax. As an alternative, an application may be made under German domestic tax law to be taxed on the dividend and to receive credit for direct and underlying taxes as above. The international affiliated privilege is unaffected by the corporation tax reform law.

## **Foreign Branch Income of a German Corporation**

This again depends on whether a double taxation agreement is in existence. If no agreement exists, the foreign branch income is taxable, and credit is given for direct foreign tax corresponding to German corporation tax up to the amount of the German tax assessed on the income concerned. If a double taxation agreement is in existence, usually the foreign branch income is exempt from corporation tax and also net worth tax. This has the effect, however, of preventing the deduction of foreign branch losses.

## **ALLOWABLE DEDUCTIONS**

### **General Rules**

In general, all expenses incurred to create, preserve or protect taxable business income are deductible. Business expenses are fully deductible even though the tax authorities may suspect them of being excessive, with some exceptions as described hereafter.

### **Depreciation and Amortisation**

Depreciation of fixed assets used for trade purposes is mandatory under the tax law and cannot be made dependent on the profit of the year or varied for other reasons. The depreciation taken for tax purposes cannot exceed the depreciation shown in the commercial accounts. Furthermore, any depreciation omitted cannot be recorded in future years.

Depreciation must be calculated on the asset's cost and normal useful life. 'Cost' here is after replacement reserve applications (page 123). Depreciation by reference to replacement value is not acceptable for tax purposes.

**Methods.** The straight-line depreciation method is generally used, but the declining-balance method may be used to depreciate movable fixed assets. Where the declining-balance method is used, the rate is restricted to twice the applicable straight-line rate with a maximum of 20%. The taxpayer may change from the declining-balance method to the

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straight-line method but not vice versa. Buildings must be depreciated by the straight-line method, with the exception of those for which construction permits were applied for before 9th May 1973. Such buildings may be depreciated at defined reducing rates.

**Rates.** Depreciation rates, apart from those for buildings, are not fixed by law; they are a matter of negotiation for each individual business. However, detailed tables of recommended rates of straight-line depreciation are published by the tax authorities for the guidance of taxpayers.

It is not possible to list all the rates acceptable to the tax authorities, but examples of the rates often found in practice are:

	%
Plant and machinery	10 – 12
Office equipment	10 – 20
Motor vehicles	20 – 25
Computers	20
Industrial vehicles	25 – 33 1/3
Industrial buildings	2 (4 in special cases)
Commercial buildings	2

Fixed assets costing less than DM 800 that are not an integral part of a larger asset can be written off in the year of acquisition. Accelerated depreciation for unusual wear and tear or technical obsolescence is allowed unless the declining-balance method of depreciation is used.

On the sale of an asset, any loss suffered is deductible. Any gain made is taxable, but the gain on the sale of certain assets may, if so elected, be deducted from the cost of similar assets acquired in the same year. Alternatively it may be deferred by the use of a replacement reserve (page 123).

**Additional Depreciation.** Additional depreciation allowances can be claimed by West Berlin enterprises (page 162) and by enterprises located in border zones. Additional depreciation may also be claimed for new ships, aircraft, hospitals, and some mining equipment. To be allowable for tax purposes, both usual and additional depreciation must be charged in the commercial accounts.

**Amortisation of Intangibles.** In the balance sheet of a corporation that acquires a business (that is, assets rather than shares), for a consideration in excess of its net worth, goodwill must be recorded. This goodwill cannot be amortised for tax purposes unless its loss later becomes

evident and can be substantiated to the tax authorities. Goodwill that originates from a corporation's own business activities cannot be recorded in its balance sheet under the provisions of either commercial or tax law. It therefore cannot be amortised.

Other intangible assets may be capitalised only if purchased. Assets such as patents or know-how may generally be amortised over the relative period of protection or usefulness.

**Revaluation of Assets.** Assets may be revalued only to correct past depreciation and therefore cannot be stated above cost.

### **Special Deductions for Mining, Oil and Similar Industries**

Enterprises that exploit exhaustible natural resources may deduct exploratory costs and similar expenses by spreading them over expected production in proportion to depletion year by year.

In addition to regular depreciation, coal and ore mining industries may depreciate up to 50% of the cost of movable fixed assets and up to 30% of the cost of immovable fixed assets in the year of purchase and the next four consecutive years. After this five-year period, depreciation is computed on the balance over the remaining estimated lifetimes. If accelerated depreciation is claimed, the straight-line method for the computation of the normal depreciation must be used.

### **Taxes**

Neither corporation tax itself nor net worth tax may be deducted from taxable income. Real property transfer tax must be included in the cost of real property acquired. Municipal trade tax and other minor taxes are deductible expenses.

### **Interest**

Interest paid on loans or other debts is deductible, unless it is paid to an affiliate and the rate is considered by the tax authorities to be excessive compared with current arm's-length rates.

### **Bad and Doubtful Debts**

A corporation has some discretion in evaluating its receivables and determining the extent of any provision required to cover anticipated losses or allowances. The corporation's estimate of such losses can be overruled by the tax authorities only if it is clearly unreasonable. A general provision of a reasonable amount for unknown collection risks may be deducted for receivables not specifically adjusted.



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## **Remuneration of Board Members**

A member of the management board of an AG or a GmbH is classified in the tax law as an employee, and his remuneration generally constitutes an allowable business expense. The remuneration of a shareholder who exercises managerial or other functions as an employee must be reasonable with regard to the services rendered, because any payment deemed to be excessive is considered to represent a hidden distribution of profit instead of a deductible expense (page 131). Remuneration paid should in any event be substantiated by a service agreement.

Expenses incurred for shareholders' benefit, for example remuneration of members of a supervisory board, were not deductible before the corporation tax reform law. Now 50% of such expenses are deductible.

## **Entertainment Expenses**

Expenses of entertaining customers and others are deductible if reasonable and if clearly for business purposes. A special form, to be signed by the restaurateur, is required as evidence of these expenses. Expenses involving guest lodges for hunting or fishing, the maintenance of yachts and similar activities are not deductible.

## **Expenses Incurred in Setting Up Business**

Formation expenses, such as legal and accounting fees, court fees for registration, bank charges, capital transfer tax, and publication and printing costs are deductible as expenses of the first year of business and may not be capitalised. Expenses incurred after a corporation's articles were certified by a notary public are deductible, even if incurred prior to its actual registration in the Commercial Register.

## **Special Tax-Deductible Reserves**

Taxable income may be reduced by the deferral of certain income items. For this purpose, the tax law allows for the creation of the following reserves:

1. Reserve for price increases. When the replacement value of fungible goods held for processing or resale has increased by more than 10% during a fiscal year, the taxable income of that year may be reduced by setting up a reserve for the excess over 10%. The reserve can be released tax-free to meet subsequent falls in prices, but if not used within six years, it becomes taxable thereafter. As an exception to the general rules, this reserve need not be entered in the books of account, but in this case provision must be made for the deferred tax liabilities arising.

2. Special replacement reserve. A business enterprise that sells fixed assets which are either nondepreciable or have a lifetime of at least 25 years is permitted to deduct from taxable income the excess of the sales price over the net book value at the date of the sale, provided that the assets have been owned for at least six years. This is done by transferring the excess to a special reserve, to be utilised on replacement of those assets within two years for plant and machinery and four years for buildings and other long-term projects, by reducing the cost of any asset purchased for replacement. Depreciation of the new asset is then based on the reduced cost, which means that the undervaluation is ultimately eliminated.

3. Reserve for capital investments in developing countries. An amount equal to either 40% or 100% of the cost of an investment that creates additional jobs in a developing country (other than tourist projects) may be charged to income in the year of expenditure by the creation of a special reserve of the same amount. Whether 40% or 100% is taken depends on an official classification of the developing country concerned. The investment can be the cost of share and loan capital of a foreign company (not necessarily a subsidiary), contributions by way of capital and loans to a foreign partnership or joint venture or advances made to a branch operating in the foreign country. The tax benefit is not available if the taxpayer is crystallising or increasing an existing loss by setting up this reserve. After five years, the reserve must be transferred back to income in six equal instalments, these being then taxed.

Reserves 2 and 3 above must be included in the commercial accounts, although the first reserve need not. In the commercial accounts, they are shown under a separate heading.

### **Profit-Sharing Plans and Bonuses**

Bonuses paid to employees under a profit-sharing scheme are normally deductible for the accounting year to which they relate, irrespective of the actual date of payment, provided that the appropriate accrual has been made.

### **Pension Contributions**

The taxation of pension plans (see Chapter 4) was reformed with effect from 22nd December 1974. The position is now as follows:

1. Unfunded pension plans. A pension provision cannot be established for an eligible employee before he or she is thirty. However, pensions for service before that age must be provided for when the

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employee becomes eligible rather than over future service as previously. The provision must be actuarially computed and the scheme legally constituted; if these conditions are met, transfers to the provision are deductible. For reinsured plans, surrender values must be capitalised in the employer's balance sheets.

2. Funded pension plans. Life insurance premiums and actuarially calculated contributions to pension funds are deductible. An excess of a pension fund's net worth over the amount needed to provide pensions in accordance with the insurance companies law is taxable, unless this excess is used to increase benefits or to reduce contributions.

In general, an employee's taxable income includes his employer's contributions to funded pension plans or for life insurance, but the employee's tax liability may be borne by the employer at a reduced tax rate on a limited amount of contributions, if certain conditions are met.

3. Employees' welfare fund. An employer's contributions are deductible only to the extent of benefits paid and the accumulation of a provision for future benefits. If the fund's net worth exceeds prescribed limits based on contributions, 25% of the excess is taxable.

## Gifts and Donations

Gifts other than to employees (for example, to customers) are deductible only up to DM 50 per person per year. Such gifts must be durably marked with the donor firm's name. Donations for charitable, religious or public benefit purposes are deductible, limited to the higher of 5% of the taxable profits (10% in the case of contributions for scientific purposes) or 0.2% of the sum of the total sales and payroll figures for the year. Deduction of contributions to political parties is limited to DM 600 per year.

## Intercompany Transactions

All transactions among related corporations, whether resident or non-resident, must comply with the arm's-length rule. Thus, payments or charges are deductible if prices of goods provided or services rendered are reasonable. Loans, royalties, management services, etc. should be evidenced by written agreements concluded in advance. Management services and related charges and expenses should be specific and identifiable. All intercompany transactions, particularly with nonresident corporations, are subject to critical examination by the tax auditors, and excessive charges are deemed to be constructive dividends (page 131).

## TREATMENT OF GROUPS AND LOSSES

### Loss Carryforward and Carryback Periods

Losses may be carried forward for five years, except by an entity that has changed the nature of its trade, even by the surviving entity of a merger. Loss carrybacks for one year are mandatory up to DM 5,000,000, but the loss carried back can be offset only against the previous year's income net of distributions and the corporate income tax thereon. The balance of a loss in excess of DM 5,000,000 is carried forward in the normal manner. No loss carryback is permitted for municipal trade tax purposes.

### Special Rules for Groups (*Organschaft*)

Under the *Organschaft* rule, which is an extension of the 'affiliated privilege' (page 117), the entire profits or losses of a controlled corporation (AG, KGaA or GmbH) may be pooled with those of its domestic parent entity, whatever its legal form, with the result that the total group income is taxed as one in the hands of the parent for the purposes of both corporation and municipal trade taxes.

To qualify for this treatment, the following conditions must be met:

1. The parent entity must hold directly or indirectly more than 50% of the voting rights of the controlled corporation.
2. Parent and subsidiary must be integrated in both economic and organisation matters to such an extent that the subsidiary corporation has no freedom of decision left.
3. A binding agreement must have been made between the two entities whereby the parent takes over the profits or assumes the losses of the subsidiary for a period of at least 5 years. (Such an agreement is not required for municipal trade tax purposes.)
4. The parent entity must carry on a trade or business or be a corporation holding several subsidiaries.

This privilege also applies to a German branch of a foreign entity, if the branch itself meets conditions 1 to 3 above, and holds the shares of the subsidiary.

The *Organschaft* rule is unaffected by the corporation tax reform law.

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## TAX TREATMENT OF INCENTIVES

The investment incentives described in Chapter 2 are supported by special tax benefits.

### Investment Subsidies

The investment grants and subsidies listed in Chapter 2 from federal sources are neither taxed as revenue receipts nor do they reduce the cost of the asset concerned for depreciation purposes. Grants and subsidies from state sources, on the other hand, are taxable.

### Accelerated Depreciation

At present, there is an additional incentive in the form of accelerated tax depreciation on cost. Business entities situated in the border zones may depreciate equipment by 50% and buildings by 30% of cost in the year of acquisition, or over the first five years. Such accelerated depreciation is additional to the normal depreciation charge, but it may not be claimed if the result would create or increase a loss for the year.

## CORPORATIONS NOT RESIDENT IN GERMANY

### General Rules

Nonresident commercial entities are subject to tax in the Federal Republic on their German source income in the form of withholding taxes or by assessment.

1. If the nonresident entity is deemed to have a permanent establishment or permanent representative in Germany, its income from all German sources is taxed through this permanent establishment or permanent representative. A 'permanent establishment' is widely defined as a physical facility or installation in which business is carried out, and a 'permanent representative' is a resident commission agent whose activities are controlled by a nonresident. However, as double taxation agreements usually provide that a subsidiary company is not of itself considered a permanent establishment, it is the unincorporated German branch of a nonresident entity that is particularly concerned with this rule. The taxable income of such a permanent establishment from German sources is determined, just as for a resident corporation, from regular accounting records that should be maintained in Germany. Charges by foreign head offices (such as for interest, royalties and know-how) are not accepted as deductible business expenses of the permanent

establishment. No withholding tax is payable on the remittance of profit (see page 145). Capital losses are only deductible to the extent that the loss is directly connected with German-source income. As for German resident corporations, ordinary capital gains are treated as taxable income.

2. If no permanent establishment or permanent representative is deemed to exist, the German-source income of the nonresident commercial entity is taxable by withholding or assessment. Assessment is required if income is earned from any category not covered by the withholding tax rules. Tax is assessed on the basis of the categories of income in the income tax law (see page 135). Expenses directly connected with any such category of income may be deducted, and a net operating loss carryover is available in these limited circumstances.

To summarise: if no permanent establishment is deemed to exist, three possibilities must be considered:

- **Business income.** In the absence of a permanent establishment, there can be no taxable business income.
- **Capital gains from sale of shares in resident corporations.** If more than 25% of the share capital in a resident corporation is held by one nonresident corporation for five years, even though the latter may have no permanent establishment in Germany, any gain on a sale or disposition of more than 1% of that share capital in any calendar year is taxable. This circumstance is rare because of the effect of double taxation agreements.
- **Income from capital investments.** Generally, income such as interest, dividends, rentals, and speculative gains from real estate from German sources is subject to tax. If the income is not attributable to a German permanent establishment or representative, it is considered as arising from a German source if the domicile, statutory seat, or principal place of management of the payer is situated in the Federal Republic.

## **Relief under Double Taxation Agreements**

The tax agreements entered into by Germany affect the income summarised above as follows:

1. **Business profits.** The treaties confirm the fiscal authorities' right to tax profits arising from a permanent establishment in Germany.

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However, the definition of permanent establishment is usually narrower in the treaty than in the national tax law. For example, warehouse facilities and liaison offices of French, UK or USA companies would be nontaxable under the relevant treaties, which override German law.

2. Capital gains from the sale of shares in resident corporations. Under most treaties, a capital gain made by a nonresident is exempted from German tax provided the gain is not connected with a permanent establishment in Germany, and is not made from a sale of 'immovable property.' Shares or bonds do not constitute immovable property, and hence no capital gains on these are taxable.

3. Income from capital investments, etc. In general, the rate of tax withheld on interest is reduced under the treaties. The rate on dividends is also reduced, but if 25% or more of the shares are held, there is no reduction. A table showing the effect of some double taxation agreements on these types of income is given on pages 156-157. No reduction or exemption will be given if the income is from immovable property or is connected with a German permanent establishment.

## REORGANISATIONS AND LIQUIDATIONS

### Tax-Advantageous Reorganisations

As a rule, the transfer of assets and liabilities of a corporation, AG or GmbH, to another results in a taxable gain arising from the difference between the consideration received and the book value of the items transferred. If, however, the transferor's property in its entirety is transferred against shares of the transferee corporation, and transferor and transferee are both domestic corporations, the taxation of the gain is deferred until ultimate sale of the shares by the transferor, when any gain is taxable. The same applies if a resident individual or domestic corporation transfers a business in its entirety or in part (for example, one trading division) at book value to a domestic corporation in exchange for the latter's shares.

While the first of these relief provisions is contained in the corporate income tax law, the second is now part of the Reorganisation Tax Law of 1977 introduced by the reform of the corporate income tax law.

Neither of these relief provisions applies to a nonresident transferor, as his future gain from the disposal of the shares would not be taxable in

Germany. Therefore, his property must be transferred at going concern value (*Teilwert*). Any gain is, however, taxed at only half of the rate of tax concerned.

Most reorganisations will incur capital transfer tax (page 152).

The following types of reorganisation may produce tax advantages, in that any gain is either not charged to tax or the tax is deferred.

1. The merger of one AG into another AG, or of an AG or GmbH into its parent corporation, provided the parent owns the subsidiary's total equity. In both types of merger, the continuing entity must not change the book values of either entity's assets or liabilities.
2. The exchange of the whole or part of the trade or business for shares in the acquiring corporation.
3. A share-for-share takeover by a domestic corporation, as long as 100% of the share capital of the corporation taken over is acquired.
4. The transformation of a resident corporation into a resident partnership or sole proprietorship in conjunction with the detailed provisions contained in the corporation tax reform law.
5. The transformation of an AG into a GmbH or vice versa provided that book values are unchanged.

## Liquidations

The period of liquidation of a corporation may extend over several years, and during that time many differences may arise between the balance sheet value of assets and liabilities at the commencement of liquidation and the ultimate net proceeds (or open market values if disposed to connected persons). Differences resulting in net gains are taxable at the normal rate as ordinary income of the corporation being liquidated. Trading or other losses brought forward by the corporation may be set off against such gains. Under the corporation tax reform law, such gains are taxed as undistributed profits at the rate of 56% until distributed when the 36% rate on distributed profits applies. A resident recipient receives an imputed credit for the tax paid just as if the distribution were a dividend. On liquidation, distributions out of reserves are treated in the same way as normal dividends paid by a corporation, as described in the next section.



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## Effect on Shareholders

In general, the cost of the shareholder's interest for tax purposes is unchanged in the reorganisations described.

A gain on liquidation made by an individual shareholder is taxable as a capital gain (page 137), and thus a gain on any holding of 25% or less is not taxable.

## RATES OF CORPORATION TAX

### General Rules

For financial periods ending after 31st December 1976, resident corporations are taxed at 56% on undistributed profits and at 36% on distributed profits. This is illustrated in the table on page 154. Before the corporation tax reform law, a distinction was made between 'qualifying dividends' and 'hidden distributions' as described below. From 1st January 1977, this will no longer be the case, and the manner of distribution will have no tax effect on the distributing company. A reduction in rates applies to West Berlin income (page 161).

The rate of tax applicable to entities not eligible for the imputed corporation tax credit (see page 117) is 50%. Such entities, it will be remembered, are permanent establishments or branches of nonresident corporations, mutual insurance associations, and business operations of public legal entities such as state banks.

Foreign investors frequently overlook the high rates of municipal trade tax, and also the net worth tax, when considering the probable burden of German taxes; readers' attention is therefore directed to pages 149 and 150 so that the total effect may be appreciated. While municipal trade tax is deductible for corporation tax purposes, net worth tax is not.

**Rates before 1st January 1977.** Before the corporation tax reform law, the rates were 52.53% on undistributed profits and 15.45% on profits paid out as 'qualifying dividends.' These effective rates comprised the basic rates of 51% and 15% with a 3% surcharge on the tax. The tax payable on distributed profits was not regarded as a distribution itself and was therefore also subject to the 52.53% tax on undistributed profits. This was the so-called 'shadow effect.' When the maximum amount possible was distributed, the corporation tax liability on the taxable income (after trade tax and disregarding non-deductible expenses) amounted to 24.57%, and the dividend to 75.43%.

Branches of foreign corporations were taxed at 50.47% (basic rate 49% with 3% surcharge).

An illustration of these rates is shown on page 155, and it is useful to compare these with the new rates on page 154.

## **Qualifying Dividend**

This is a distribution effected by formal resolution of the competent shareholders' meeting.

Before the corporation tax reform law, if funds were needed within the German subsidiary corporation, advantage could be taken of the old lower tax rate by the declaration of dividends that were then lent back to the paying corporation. Exceptionally, a parent corporation resident in the USA could not reinvest in this way in excess of 7½% of the amount of the dividend within certain time limits; to do so would increase the reduced rate of the dividend withholding tax to the normal rate under the terms of the double taxation agreement.

## **Hidden Distributions**

Prior to the corporation tax reform law, a profit distribution not sanctioned by a shareholders' resolution did not qualify for the reduced rate of tax applicable to distributed profits. This is not the case after 1st January 1977. Such a distribution was called a constructive or secret dividend. This term was used to denote a hidden distribution of profits to a shareholder, who thereby received a benefit from the company without giving adequate consideration in return. Examples of constructive dividends are excessive interest rates paid on loans from shareholders, unduly high salaries of officers who are also shareholders, and excessive intercompany charges such as management fees above the normal commercial rate.

The normal withholding tax was applied to any constructive dividend, making the total tax liability, including the trade tax on income and corporation tax (depending on the facts of the case), approximately 100% of the amount of the constructive dividend.

## **Treatment of Reserves and Retained Earnings**

The 36% tax rate applies to all distributions, whether made out of current earnings or retained earnings, including taxed reserves. This comprehensive application of the 36% tax rate does not represent an additional tax burden to domestic shareholders because of the credit procedure. For foreign shareholders, the levying of an additional 36%

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tax on a distribution out of retained earnings already taxed, or on a distribution out of retained earnings arising before 1st January 1977, would have amounted to double taxation. The law therefore provides that the additional 36% tax on distributions out of retained earnings arising before 1st January 1977, and on a limited number of other distributions, will be refunded upon application to the Federal Office of Finance (*Bundesamt für Finanzen*). No refund is possible if the shares of the distributing company are held by a German permanent establishment of the foreign shareholder. In view of this rule, it is not necessary for subsidiaries of foreign entities to distribute all earnings before 1st January 1977.

Another effect of the provision subjecting all distributions to the 36% tax is that it then becomes necessary to differentiate between the sources of the funds being distributed. Regarding the distributing entity, distributions out of reserves created free of or at a reduced rate of tax (for example, foreign branch income), or created prior to 1st January 1977, are subject to the 36% tax. If the distributions are from reserves created out of fully-taxed income under the new system, i.e., after 1st January 1977, the original tax paid must be reduced to 36%. Reserves, therefore, have to indicate what tax, if any, was paid on the income used to create them.

The new corporate tax law treats distributions as coming first from current income, then from retained earnings taxed at the highest rate, then from retained earnings taxed at reduced rates, then from retained earnings derived from foreign tax-free income, then from domestic tax-free income, and finally out of retained earnings created before 1st January 1977.

## Relief for Small Company Incomes

A corporation with a taxable income below DM 10,000 may deduct one-half of its income in computing its tax liability. The deduction decreases rateably from DM 5,000 to zero for incomes in the range from DM 10,000 to DM 20,000. This relief cannot be claimed if any distribution is made.

Under the tax law before the corporation tax reform, resident corporations that were at least 76% owned by private individuals during the entire tax year, and did not have assets exceeding DM 5 million, could pay tax on a special scale, graduated up to a maximum of 50.47% (basic rate 49% + 3% surcharge) on retained profits in excess of DM 50,000. However, the rate payable on qualifying dividends on this special scale

was 27.3% (basic rate 26.5% + 3% surcharge); small companies could therefore elect to be taxed at the normal rates described. An election to be assessed at the normal rates could not be revoked for five years.

## **TAX RETURNS – FILING, ASSESSMENT AND AUDITS**

### **Fiscal Periods**

The fiscal period or tax year is normally the calendar year. Commercial entities whose accounting year does not coincide with the calendar year have as their fiscal period the accounting year ended within the calendar year.

### **Filing of Tax Returns**

The due date for filing is announced annually by the tax authorities. This date is usually 31st May following the tax year. If returns are not filed by the prescribed date the tax authorities can impose a penalty of up to 10% of the total annual tax. As a rule, however, on application by the taxpayer, filing may be delayed until the end of September if a tax adviser is assisting in the preparation of the tax return. Following the review of the return by the authorities, a notice of assessment is issued to the taxpayer.

### **Advance Payments of Tax**

The notice of assessment indicates the advance payments that must be made on account of the current year's corporation tax liability, based on the tax assessed for the previous year. These payments must be made quarterly on 10th March, June, September, and December; and if payments on the earlier dates require adjustment, either up or down, the later payments are amended.

### **Payments of Tax and Tax Audits**

In the assessment notice, the advance payments for the previous year are deducted from the assessed tax. The taxpayer must pay the balance due as stated in the assessment notice within one month. However, the assessment on commercial entities is not final until a tax examination or audit has been carried out. As a rule, for large corporations this examination takes place once every three years, but for small ones the intervals are longer. The tax examination, always carried out at the corporation's own offices, covers all taxes, but the wage tax (page 141) is examined by specialist tax auditors. The results of these examinations are discussed with the taxpayer, who receives a tax audit report followed by additional assessment notices if these are required.

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## Appeals

An appeal against any assessment must be filed with the tax office within one month of receipt of the assessment notice. Further appeal lies with special state tax courts and thence to the Supreme Federal Tax Court in Munich.

## Statute of Limitations

The period for assessment and collection of corporation tax is limited to five years, starting at the end of the year the tax became due, unless an extension period is granted to the taxpayer in cases of hardship or an investigation into suspected tax evasion or fraud is initiated by the tax authorities.

## Interest on Underpayments and Overpayments of Tax

Under the old corporate tax system, interest was not charged on underpayments of tax, nor was interest given on overpayments. This matter was discussed during the passage of the new fiscal code through Parliament; introduction of interest charges was deferred, however, probably until 1980, due to technical difficulties.

## TAXATION OF INDIVIDUALS

### RESIDENCE AND NONRESIDENCE

#### Definition of Residence

A resident individual is one whose residence or customary place of abode is in the Federal Republic or West Berlin. A 'customary place of abode' in Germany is deemed to exist if the individual is physically present there for more than six consecutive months. Short absences from the country are not deemed to interrupt the consecutive period, and such time spent abroad is eliminated from the application of the six months' rule. It is not necessary for the six-month period to fall within one calendar year. Once the six-month period has expired, residence dates back to the beginning.

#### Effect of Residence or Nonresidence

Resident individuals are subject to tax on their worldwide income but nonresidents on their income from German sources only. In computing taxable income, a nonresident may deduct expenses incurred in connection with his income, but may deduct special expenses only if he has income from employment in Germany. Residents are entitled to exemptions and personal allowances, but nonresidents may claim only a standard deduction of DM 840. Residents are taxed at the rates set out

on page 140, but for nonresidents the minimum tax rate is 25% (excepting employment income and certain capital gains for which the tax rate may be lower), with regular rates applying to higher taxable incomes. Income splitting is allowed only when both taxpayers are residents.

## **Exceptional Treatment of Nonresidents**

The tax law grants some relief to nonresidents rendering special services by taxing them at a special low rate, to be negotiated in each case. Such treatment requires that the services rendered be in the special interest of the economy; it has been allowed only in a few exceptional cases.

## **TAXABLE INCOME**

### **Categories of Income**

Income is taxable if it falls into any one of the following seven categories:

1. Agriculture and forestry (*Land-und Forstwirtschaft*)
2. Business or trade (*Gewerbebetrieb*)
3. Independent personal services (*Selbstständige Arbeit*)
4. Employment (*Nichtselbstständige Arbeit*)
5. Investment of capital (*Kapitalvermögen*)
6. Rentals, including royalties (*Vermietung-und Verpachtung*)
7. Miscellaneous income (*Sonstige Einkünfte*)

Of these, the first is not significant to most foreigners, and will therefore not be discussed.

### **Income from Business or Trade and from Independent Personal Services**

These two categories include income from related sources such as income from the investment of capital, trade rentals and royalties. An individual's taxable income in these categories is subject to the same rules as those for corporations. The rules as to valuation methods, depreciation and business expenses apply generally, except that in determining taxable income derived from professional or other indepen-

# Taxation in Germany

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dent personal services, the commercial accounting and valuation rules are not usually applied. Instead, income is normally computed on a 'cash' basis.

## **Income from Employment**

This includes salaries, wages, gratuities, and other benefits in cash or in kind, together with pensions and income from former employments. Additional payments for Sunday, holiday, and night work, however, are exempt from tax. Employees are subject to the wage tax on their employment income; wage tax is credited against any income tax payable if the level of income requires assessment to income tax (page 141).

## **Income from Investment of Capital**

This comprises the gross amount of dividends (including constructive dividends) and interest on loans and bonds (including bank deposits), and shares of profits received by silent partners. Any tax deducted at source from such income, that is, the 25% dividend withholding tax described later in this chapter, is credited against the tax due on this income. In addition, from 1st January 1977, a resident individual receives the imputed tax credit on distributions by German resident corporations out of earnings of financial periods ending after 31st December 1976 in the manner described earlier.

## **Rental Income**

This comprises receipts from letting or leasing immovable property or movable business assets, and royalties on copyrights, patents, and certain building and mineral rights. Also taxable in this category is the notional annual value of the taxpayer's private residence, based on a standard value as described on page 151.

## **Miscellaneous Income**

This includes income from life annuities, other recurrent payments and benefits, casual profits, profits from speculative nonbusiness transactions such as dispositions of real property held for less than two years or movable property (for example, securities) held for less than six months, and other income not falling within any other category.

## **Nontaxable Items**

Income tax is not charged on nonrecurring capital receipts such as nonspeculative disposals of real property or securities (except as stated on page 137), gifts and inheritances, capital payments under life insurance policies, compensation and damages for accidents, or other external events.

Similarly, child allowances and other benefits from public funds and, within limits, social insurance benefits and severance payments are not taxable.

## **Capital Gains**

Speculative gains are taxable as miscellaneous income. These are gains from the sale of nonbusiness property held for short periods. The length of the period depends on the nature of the asset dealt in; for example, it is six months for shares, securities, or bullion, and two years for land or buildings.

An individual taxpayer's other capital gains are in general not taxable, except as follows:

1. From the sale of an entire unincorporated business.
2. From compensation for losses of income-producing activities.
3. From the sale or other disposition of a substantial investment (holding of more than 25% of the capital of a commercial business).

On application by the taxpayer, these gains are taxed at half the average rate applicable to all his taxable income (including the capital gain). His taxable income, ignoring the capital gain, is taxed at the normal rates taken from the tax tables.

An individual taxpayer's capital losses cannot be relieved by setoff, either against other income or any capital gain.

## **Taxation of Foreign Income**

A resident individual taxpayer must include his gross foreign income in his German income tax return. He may claim a credit for foreign tax suffered under German tax law and the relevant double tax treaty in respect of such foreign taxes as are equivalent to German taxes.

Credits for foreign direct taxes can never exceed the German tax computed on the foreign source income for the assessment period concerned. Excess foreign tax credits can be carried neither forward nor back. An indirect tax credit, such as may be claimed by corporations, is not available to individuals.



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## ALLOWABLE DEDUCTIONS AND PERSONAL RELIEFS

Gross income is the aggregate amount of income arising in the seven categories described. It is reduced by 'income-connected expenses' (*Werbungskosten*) incurred in earning, protecting and preserving income. The balance is further reduced by deductions for special personal expenses (*Sonderausgaben*) and extraordinary charges (*Aussergewöhnliche Belastungen*) incurred by the taxpayer.

Expenses that do not fall within these groups and are therefore non-deductible include:

1. Those incurred in disposing of income.
2. Household and family expenses (for example, the support of dependants).
3. Personal taxes (that is, net worth tax, gift and inheritance taxes and transactions taxes).
4. All expenses incurred in connection with real property not used for income-producing purposes (for example, real property tax, public dues and insurance premiums paid for the protection of personal property).
5. Depreciation of owner-occupied property.
6. Interest on private loans unconnected with income.

### Standard Deductions and Allowances

As an alternative to itemising income-connected expenses, the following standard deductions and certain additional allowances are granted annually to individual resident taxpayers.

	Standard Deductions DM	Allowances DM
Income from employment	564	580
Income from investment of capital (doubled for jointly assessed taxpayers)	400	
Miscellaneous income: life annuities (of which a portion is taxable)	200	

	<b>Allowances DM</b>
Other allowances are:	
For taxpayers aged over 64 years:	
Old age allowance given in all cases	720
Allowance against 40% of pension	Up to a maximum of 4,800
Allowance against 40% of other (i.e., non-pension income)	Up to a maximum of 3,000
For widows with dependent children	3,000

## Special Personal Expenses

These are personal expenses incurred by a resident individual taxpayer or his family; they are neither business nor income-connected expenses. They may be 'provident expenses' or 'other special expenses.' The former are incurred to secure the future of the taxpayer and his family, such as personal insurance, housing expenses, and certain savings, and are deductible up to defined limits. These limits depend on the size of the family, amount of expenses, and in some cases amount of earned income.

Other special expenses are items like church tax, the interest portion of the property levy (see Chapter 1), both deductible without limit, and contributions within certain limits for officially recognised charitable and educational purposes. Minimum standard deductions of DM 300 for provident expenses and DM 240 for other special expenses (both amounts doubled for married taxpayers) are available whether or not such expenses were actually incurred.

## Extraordinary Charges

Unusually burdensome expenses, such as those arising from accident or illness not covered by insurance, may qualify for a special hardship allowance consisting of the excess over the proportion that the taxpayer could reasonably be expected to bear himself. Also, personal allowances are granted to retired or disabled individuals who live under particularly disadvantageous conditions.

The former tax-deductible child allowances are no longer granted, but tax-free cash allowances for dependent children are now paid by government labour agencies.

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## RATES OF INCOME TAX

The first DM 3,029 of an individual's income is exempt. Thereafter, the income tax rate is 22% on income up to DM 16,000, giving an overall tax rate at that figure of 18%. The rate then increases progressively to a maximum marginal rate of 56% on an individual's taxable income over DM 130,000. The transition from one tax rate to another is graduated as illustrated below.

On 1st January 1975, a 3% surcharge and 10% temporary stabilisation charge were cancelled for individual income tax purposes.

**Table of Income Tax Rates Effective 1st January 1975**

Taxable Income	Income Tax on Individuals		Income Tax on Married Couples	
	DM	Cumulative Rate	DM	Cumulative Rate
12,000	1,980	17%	1,320	11%
16,000	2,857	18%	2,190	14%
20,000	4,159	21%	3,074	15%
40,000	12,468	31%	8,318	21%
80,000	35,552	41%	24,936	31%
100,000	43,396	43%	34,440	34%
130,000	60,101	46%	49,408	38%

## Income Splitting

Married residents may be taxed separately on their respective incomes. Alternatively, they may elect to be taxed jointly, in which case their total tax payable is twice the tax on half their joint income. For example, a married couple whose income is DM 80,000 will pay twice the tax of an individual with an income of DM 40,000, and so benefit by being charged at a lower tax rate.

## CHURCH TAX

This tax (*Kirchensteuer*) is levied and collected by the tax offices on behalf of the Roman Catholic, Protestant and Jewish communities. The taxpayer's church membership should therefore be made known to the tax office. It is possible to obtain exemption from this tax by making a statutory declaration before the courts, indicating withdrawal from membership. Usually, church tax is 8% to 9% of total income tax or wage tax.

## WAGE TAX

Income from employment, as defined earlier in this chapter, is subject to wage tax (*Lohnsteuer*). Every employee receives an annual wage tax card from his municipality on which his wage tax class, based on his personal circumstances, is recorded. In accordance with this wage tax card, the employer must withhold wage and church taxes from every salary or wage payment according to the wage and church tax tables, and must pay both taxes periodically to the local tax office. Social security contributions are similarly withheld and paid over. The wage tax tables show the tax due, net of tax-exempt amounts and deductions for special personal expenses on the basis of the standard deduction. On the employee's application at the end of the tax year, wage tax paid may be recomputed from an annual wage tax table, and any excess tax deducted is repaid. After the year-end, the wage tax card showing gross income from employment, amount of wage tax, church tax, and social security contributions withheld by the employer is returned to the local tax office.

The wage tax is the employee's final liability unless an assessment to income tax is required, or is applied for by him for any reason. An income tax assessment will be made: first, if the taxpayer's annual income from all sources exceeds DM 48,000; second, if his gross annual income from nonemployment sources exceeds DM 800; or, last, if he has received employment income from more than one employer during the year and his taxable income exceeds DM 32,000. Wage tax suffered by a taxpayer is credited against his income tax liability.

## RETURNS AND ASSESSMENTS

### Filing of Tax Returns

The due date for the filing of income tax returns is announced annually by the tax authorities. It is usually 31st May following the tax year (the calendar year). On application by the taxpayer, filing may be delayed until the end of September if a tax adviser assists in the preparation of the return. If returns are not filed by the prescribed date, the tax authorities can impose a penalty of up to 10% of the total tax payable for the year. Some time after the tax return is filed, an assessment notice is issued to the taxpayer.

An individual whose wage tax card has been filed and whose income is below the stated limits need not file an income tax return. All other residents, and nonresidents who have German source income (unless this is taxed by withholding), must file a return.

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## **Payment of Tax**

Advance payments of income tax, based on the income tax assessed for the previous year, wage tax, and other withholding taxes deducted are taken into account in arriving at the balance of income tax due. The tax balance must be paid within one month of receipt of the assessment notice. This notice also states the advance payments of tax for the current year, due on 10th March, June, September, and December.

## **Appeals Procedure and Statute of Limitations**

The corporation tax rules set out on page 132, with necessary modifications, apply to income tax.

## **Tax Clearance on Leaving the Federal Republic**

German tax law does not require special tax clearance for any individual leaving the country. The tax authorities may, however, make claims on property owned by the taxpayer in the Federal Republic to satisfy any outstanding tax debt.

## **FOREIGN TAX LAW**

On 1st January 1972, a new law commonly called the 'Foreign Tax Law' came into effect. Its full translated title is 'An Act to ensure equality of tax treatment in international relationships and to improve the competitive situation regarding the taxation of foreign investments;' the title thereby revealing its purpose. The main topics dealt with in this law, and detailed below, are intercompany pricing, the taxation of German nationals who leave the Federal Republic and the attribution of foreign income to resident taxpayers. Other topics, such as indirect tax credits, are described elsewhere.

### **Intercompany Pricing**

The tax authorities are entitled to adjust the income of a resident taxpayer if his income is reduced by transactions with a related non-resident that are not at arm's-length. The term 'related' means that one of the parties participates directly or indirectly in at least 25% of the other's capital, or is able to exert directly or indirectly a controlling influence over that other. Alternatively, a related party is one where a third party either holds 25% or more of the shares or is able to exert a controlling influence on both parties to the transaction. In all instances, it is irrelevant whether control has actually been exercised. This law is similar to the USA's 'Section 482' legislation.

### **German Nationals Leaving the Federal Republic**

If a German national has been resident in the Federal Republic for five of the preceding ten years, he will, on emigrating to a country with lower taxation rates than the Federal Republic, be liable to German taxation (income tax, net worth tax and inheritance tax) for the following ten years as long as he maintains substantial economic ties with the Federal Republic.

In addition, if an individual who has been resident there for ten years terminates his residence, a deemed capital gain will arise on any interest of 25% or more in a domestic corporation. This would be taxed like a capital gain of the same nature (page 137).

### **Attribution of Foreign Income to Residents**

The law provides for the taxation in Germany of income of dependent nonresident companies ('intermediate companies') in which resident taxpayers, or emigrants as described above, hold more than 50% of the share capital, provided that the income of the intermediate companies is earned from certain 'harmful' business transactions. This income from business transactions considered to be harmful is added to the taxpayer's taxable income. 'Harmful' business transactions are those designed to minimise worldwide taxation. They do not include, for example, income from the following sources:

- production, processing and assembly
- business operations of banks and insurance companies
- trading (unless the merchandise is produced by, or delivered to, the shareholding taxpayer)
- services (unless rendered by or to the taxpayer).

In this connection, 'taxpayer' means a person of any nationality who is liable to German tax on his worldwide income, including a person who is related to such a taxpayer. The gross income, less business expenses of the intermediate company, is computed according to German tax rules and is attributed proportionately to the shareholders and subjected to German tax in the hands of the residents concerned. The tax privileges available to a German commercial entity do not apply, with the exception of the affiliated privilege, which, together with the allowance of foreign tax credits, is extended to these nonresident companies. Small foreign income (that is, 10% of the intermediate company's income, unless it exceeds DM 120,000) is exempted.

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## TAXATION OF OTHER ENTITIES

### Partnerships

A partnership is not a chargeable entity for either corporation or income tax purposes, or for net worth tax. Instead, the partnership is a unit for the computation of income to be allocated to the individual partners, who are considered to be engaged in business on their own account. The taxable income derived from a partnership is subject to corporation or income tax, depending on the status of the partner; for example, whether he is a GmbH or a private individual.

A partnership is, however, a taxable entity for the purposes of municipal trade tax and turnover or value added tax.

### Nonprofit Organisations

Entities with independent legal existence, such as cooperatives and mutual insurance associations, are subject to corporation tax. The same applies to legally dependent associations unless their income can be directly attributed to other taxpayers. Nonprofit organisations for social purposes are exempt from taxation; examples are professional bodies, employees' welfare associations and trade unions. If commercial operations are involved, the exemption could be restricted.

The income of a nonprofit organisation is classified into the various categories of taxable income applicable to an individual taxpayer (page 135). Accordingly, deductions from gross income are limited to those applicable within each category. Corporation tax is charged at the 50% rate (before 1st January 1977 at 50.47%), as the reduced rate on distributions does not apply.

### Trusts

The *Stiftung* is a foundation without an independent legal status, and is almost the equivalent of a trust established under Anglo-American law. The income of a foundation is taxable like that of any other taxable nonprofit organisation. However, the income of a family foundation can usually be attributed to the donor or the beneficiaries, and so its income (distributed or not) is taxable in Germany.

## WITHHOLDING TAXES

### Residents

Withholding taxes on residents are the wage tax and the capital yields tax on dividends and interest from convertible bonds, at a rate of 25%

for individuals and corporations. The tax need not be paid by one resident corporation paying a dividend to another provided that the *Organschaft* conditions are met. On a dividend for a fiscal year ended before 1st January 1977, tax does not have to be paid if the 'affiliated privilege' conditions applied.

## Nonresidents

Withholding taxes additionally payable by nonresidents refer to gross income from supervisory board fees of domestic corporations (30%); performances of artists, writers, etc. (15% or 25%); and royalties, including technical assistance fees (25%). German-source income, apart from items taxed by withholding, is taxed by assessment; an example is interest earned from loans secured on German immovable property.

## DOUBLE TAXATION AGREEMENTS

Most double taxation agreements negotiated by Germany follow the draft model published by the Organisation for Economic Cooperation and Development in 1963. They therefore tend to be similar in broad outline, although frequently differing in detail. The agreement concluded with Switzerland in 1971 is in line with the Foreign Tax Law passed shortly afterwards. Agreements have been concluded with the following countries:

Australia	Iran	Romania
Austria	Ireland	Singapore
Belgium	Israel	South Africa
Brazil	Italy*	Spain
Canada	Japan	Sri Lanka (Ceylon)*
Denmark	Liberia	Sweden
Egypt	Luxembourg*	Switzerland
Finland*	Morocco	Thailand*
France	Netherlands*	United Kingdom*
Greece	Norway*	United States of America*
Iceland	Pakistan	Zambia
India*	Poland	

\* *Revision or renegotiation pending.*

Agreements are under negotiation with or are planned for:

Argentina	Cyprus	Kenya
Bangladesh	Czechoslovakia	Jamaica
Burma	Ecuador	Malaysia
Chile	Indonesia	Malta



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New Zealand	Soviet Union	Turkey
Philippines	Tanzania	Uganda
Portugal	Trinidad and Tobago	Yugoslavia
South Korea	Tunisia	

Agreements limited to income from shipping and air transport have been signed with:

Afghanistan (air only)	Lebanon
Chile (shipping only)	Syria
Colombia	Uruguay
Ethiopia (air only)	Yugoslavia (shipping only)
Iraq	

The effect of the full treaties on dividend and interest and royalty withholding taxes for selected countries is shown in the table on page 156. The corporation tax reform law has the effect of increasing the tax burden on German subsidiaries of foreign corporations, bearing in mind that in most cases where more than 25% of the shares are held the full rate of the capital yields tax on dividends of 25% is applied (see comparisons on pages 154 and 155).

The German government has stated that it will undertake negotiations with the countries affected for the amendment of existing double taxation treaties to reduce the effect of the new corporation tax law. The most likely channel for a reduction in the tax burden is the dividend withholding tax rate. Whether this will happen in the case of the United States is problematical, since the withholding rate to that country is already at the lower rate of 15% where there is no reinvestment of dividends.

It is likely, therefore, that most German treaties will be renegotiated. In the case of the EEC member states (with each of which Germany has a treaty), it is to be expected that EEC draft directives on tax harmonisation will be considered in any discussions on new treaties.

## VALUE ADDED TAX

Value added tax (*Mehrwertsteuer* or *MWS*), referred to below as VAT, was introduced on 1st January 1968. This tax is levied on the amount invoiced by an entrepreneur (someone who exercises an independent business activity) within the scope of his business for goods delivered and services rendered within the Federal Republic. A group of companies is treated as one taxable entity, so that sales and services by

subsidiaries are attributed to the parent for VAT purposes; intergroup transactions are exempt from VAT. The conditions of a group relationship (*Organschaft*) must be met for this purpose, but a written pooling agreement is not required. The parent company of an *Organschaft* may be foreign, with the result that services rendered to it by its German subsidiary will not be liable to VAT.

A delivery is deemed to have taken place where the commodity is situated at the time the power to dispose of it is transferred. If the goods are shipped to a customer, delivery takes place where shipment begins (subject to special rules governing imports).

A service is any one of a wide variety of activities such as leasing of equipment, licencing of German patents or know-how, or rendering of professional services. The service is deemed to be performed at the place where the major part of the activity is carried out.

## **Mechanics of VAT**

Every month, the entrepreneur determines the total of the VAT he was charged on goods and services received from his suppliers. He is entitled to credit this tax (including the import turnover tax) against his own liability to the tax authorities for the total of the VAT he has charged to his customers for deliveries made and services rendered by him within the same period. A declaration must be filed within ten days after the end of each month and, simultaneously, the VAT due must be paid. Any excess of tax on charges inward over charges outward will be repaid on application. The entrepreneur is obliged to keep detailed records for VAT purposes. At the end of the calendar year, he must submit a tax return for the year, after which he will be sent an annual assessment notice. For late payment, a fine of 1% for each month is imposed, and for inexcusably late filing, a 10% flat rate penalty is charged.

The due date for payment of VAT is normally determined by the date of delivery of the goods or performance of the services, irrespective of the date on which the invoice is rendered. Consequently, advance payments made prior to final delivery of the finished product are not subject to tax at the time of payment. The rate of VAT must be stated on all invoices, and the amounts shown separately on invoices exceeding DM 100, as otherwise the tax paid cannot be recovered.

## **Exemption from Tax**

Exemption from VAT is granted for such transactions as leasing of real estate, services of physicians and hospitals, banking and monetary

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operations, and insurance business. Transactions falling under the real estate acquisition tax provisions, the insurance tax law, and the capital transactions tax law are also exempt from VAT. Tax charged on purchases and services received cannot be recovered if they are connected with transactions that are tax-exempt. If a business consists of transactions partly exempt and partly taxable, apportionments of the tax on charges inward are made.

Exports are also exempt from VAT, but the tax charged on goods and services purchased for export may be recovered.

## **International Operations and Import Turnover Tax**

Imported goods are not subject to VAT, but to an import turnover tax. This tax is raised irrespective of whether customs duty is payable. If know-how is made available from abroad, it is deemed to be a service not rendered in Germany, and is therefore exempt from this tax. Goods exported from the Federal Republic, know-how (but not patent royalties) utilised abroad, processing for foreign customers, and cross-border transportation are all tax-exempt.

## **Tax Rates**

VAT is levied on the net price paid for goods sold or services rendered. At present, the rate is generally 11%; but for most foodstuffs and some professional services, it is 5.5%. The import turnover tax is charged at 11% on the customs value. Special reductions in the tax payable apply regarding West Berlin operations and also for transactions with East Germany. An increase in the higher rate to 13% and the lower rate to 6.5% is under discussion.

## **Patent Royalties**

Patent royalties payable by a resident entrepreneur to a nonresident are subject to VAT at the rate of 11%. In some EEC member states, for example the Netherlands and Belgium, this may be offset against the recipient's VAT liability in his country of residence, but in most cases it is effectively an additional withholding tax.

## **Small Businesses**

Any business with an annual turnover not exceeding DM 12,000 is exempt from charging VAT to its customers but cannot recover VAT charged to it by suppliers. Businesses with annual turnover between DM 12,000 and DM 60,000 can elect to be subjected to a turnover tax (not VAT) at the rate of 4% on invoiced amounts above DM 2,000. Turnover tax cannot be claimed by the customer and must not be shown in

the invoice of the supplier. A small business need not make this election, and thus can be included in the normal VAT system so as to recover tax suffered.

## MUNICIPAL TRADE TAX

Municipal trade tax is assessed in two and sometimes three ways:

1. On income
2. On capital
3. On the payroll of commercial enterprises (generally only in the northern and western parts of the country).

The first is based on the business and professional income subject to income tax or corporation tax, and the second is based on capital subject to net worth tax. There are some significant adjustments to the tax base in both cases: for example, long-term liabilities are added to capital, and interest paid thereon is added to income. The third way of assessing municipal trade tax is commented on below. As the total of the various assessments averages over 16% of gross income, this tax is very significant to most business taxpayers even though it is deductible for income and corporation tax purposes.

It should be noted that, for municipal trade tax purposes, from April 1974 the affiliated privilege applies, thus exempting resident shareholders' dividends from the trade tax on income under the conditions explained on page 117.

Also, for the municipal trade tax on capital, if the two conditions for the affiliated privilege are satisfied, the shareholding is excluded from the amount of net worth. This position has not been affected by the corporation tax reform law. The *Organschaft* provisions also apply for municipal trade tax purposes. A corporation's share of a partnership is exempt from municipal trade tax since the partnership is itself charged to municipal trade tax.

### Computation and Rates

The tax is computed in two stages. First, the provisional federal rates of 5% on income and 0.2% on capital are applied to the respective bases.

The second stage is the application to the resulting figures of a multiple imposed annually by each municipality. Municipalities that do not levy

# Taxation in Germany

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a trade tax on payroll apply a multiple factor at present ranging from 320% to 400%; thus the rates of municipal trade tax generally charged are between 16% and 20% on income and between 0.64% and 0.8% on capital.

If a payroll tax is levied, the provisional federal rate on the total of gross salaries and wages of 0.2% is subject to a multiple of between 600% and 900%. A lower multiple is then applied to the two other tax rates.

For foreign tax credit purposes, relief is generally available only for the income portion of the municipal trade tax.

## NET WORTH TAX

Resident individuals and corporate entities (and also certain non-residents of German nationality) are liable to tax on their worldwide net worth. Nonresident individuals and entities are taxed on their property in Germany, although their bank accounts, unsecured claims against resident debtors, shares, bonds and other German securities, and similar assets are exempt from this tax. Persons who become subject to the net worth tax on their worldwide property by establishing residence in Germany may be taxed for the first ten years at a flat rate, which is lower than the regular tax charged.

If the conditions of the affiliated privilege (see page 117) are satisfied with respect to a corporation's investment in other corporations' shares, the value of these is excluded from the net worth tax. This provision is unaffected by the corporation tax reform law.

### Computation

The first DM 70,000 of a resident individual's net worth is exempt from tax. Every individual included in a joint assessment (for example, spouses and dependent children up to age 27) is eligible for this exemption. For nonresident individuals, and for all corporate entities, resident or nonresident, the corresponding figure is DM 10,000.

The property of a corporate entity is thus doubly taxed: in the entity itself and then in the hands of its shareholders or proprietors, but double taxation is avoided on holdings of at least 25% among domestic companies under the affiliated privilege rules. Unless double-tax treaty provisions apply, residents may deduct comparable foreign taxes from the German tax.

### **Valuation of Real Property**

Standard values of real property were assessed on 1st January 1964 and were applied for the first time on 1st January 1974. This resulted in considerable increases over the 1936 values previously applied. The 1964 values are currently increased by 40% to take account of the change in market prices since then.

### **Returns and Rates**

At three-year intervals, every taxpayer must submit a declaration of his net worth, including all his property less his liabilities. During the three-year period (unless a reassessment is applied for or is required because of substantial changes in the taxpayer's status), individuals pay net worth tax at 0.7% each year. Corporate entities pay tax at 1%, although for 1974 the rate was 0.7%. Net worth tax paid cannot be deducted from income for any other tax purpose by either corporate entities or individuals.

## **MISCELLANEOUS TAXES**

### **Inheritance and Gift Tax**

Property acquired by inheritance or gift is subject to the inheritance and gift tax. Where either the deceased, or the donor, or the recipient is resident in Germany, tax is assessed on all property wherever situated; where neither party is resident, the tax is levied only on property situated in the Federal Republic. The tax is assessed on the beneficiary or donee according to the amount of the property received. The rates vary with the degree of relationship between the beneficiary and the deceased, or donor, and the value of the property transferred. If the beneficiary does not pay the tax, it can be collected from the donor or the estate of the deceased.

Transfers of most kinds of property are taxable. With certain limitations, occasional gifts, gifts for the support of education, gifts of household property or objets d'art and collections, and donations to public appeals are not taxable.

Residents enjoy substantial exemptions. A widow or widower may deduct DM 500,000 from the value of taxable property inherited from her or his spouse. A child is entitled to a general deduction of DM 90,000 and a further relief that decreases with age from DM 50,000 at birth to zero at age 27.

# Taxation in Germany

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Tax rates are graduated by class of taxpayer and amount of taxable property. For example, in Class 1 (spouse and children), the rates range from 3% to 35% and in Class 4 (unrelated persons), from 20% to 70%, on amounts up to DM 50,000 and over DM 100,000,000 respectively. Tax on successive transfers between persons in Classes 1 and 2 (spouse, children and their descendants) by reason of death within ten years is reduced by including all transfers in the tax basis and deducting the tax previously paid.

Real estate is valued at the 1964 assessed value increased by 40% to update it to current price levels. The heir to a business or agricultural property may request that payment of tax be deferred for up to seven years if the tax liability would result in the discontinuance of operations.

Family foundations are subject to a substitute inheritance tax charged every thirty years. For this purpose, taxable property is reduced by twice the amount of the exemption for a child, and the tax is computed at the rate for Class 1 on half the amount of the taxable property involved.

## **Real Estate Tax**

This tax is levied on owners of real estate located in Germany and is based on the standard values assessed in 1964, not including the 40% increase added for net worth tax purposes. Tax rates range from 0.7% to 1.3% according to the value of the property.

## **Transfer Taxes**

These are charged on the following transactions:

**Real Estate Acquisition Tax.** Tax is levied on transfers of real estate, excepting transfers subject to inheritance and gift tax, and on acquisitions by one person or group of all the shares in an enterprise owning real estate. The basis of assessment is the purchase price or the equivalent market value in the case of transfers other than purchases. The normal rate of tax is 7%, but this rate is reduced to 6% on a transfer of real estate to a company as a shareholder's contribution to share capital.

If real estate owned for business purposes by a partnership or sole proprietor is transferred to a corporation solely for the issue of shares, no real estate acquisition tax is charged. This provision was introduced under the 1977 reorganisation tax law for five years ending 31st December 1981.

**Capital Transactions Tax.** A 1% capital transactions tax is levied on any contribution in cash or property to the capital of a domestic corporate entity or to the assets of a branch of a foreign corporation (unless that corporation has its legal seat in an EEC member state where this tax is also assessed). The tax is also payable in a few other circumstances; on a reorganisation, the rate is reduced to 0.5%. Transactions subject to this tax are exempt from VAT.

**Stock Exchange Transfer Tax.** This tax is payable at rates varying between 0.1% and 0.25% on sales and transfers of securities in the Federal Republic and is in addition to the capital transactions tax if that applies. Tax is payable on the transfer price. The acquisition of a new issue of securities and public bonds, and transactions between banks, dealers or brokers are exempt, unless in the latter case they involve interests in a GmbH company. In spite of its name, this tax is levied regardless of whether the transaction takes place on a stock exchange. It is payable within two weeks of the taxable event.

## Stamp Duties

A number of documents such as notes, bills of exchange and acceptances are subject to stamp duty. The standard rate is 0.15%, but this may be reduced in certain circumstances.

## Lotteries and Betting

Taxes of 20% are levied on the amount staked on lotteries and of 16 2/3% on betting, horseraces, etc.

## Insurance Tax

An insurance tax of 5% is charged on premiums, contributions, advances, final payments, etc.; it is paid by the insurance company.



# Taxation in Germany

## COMPARATIVE TABLES

### Comparison of Corporation and Branch Tax Rates Effective 1st January 1977

	Corporation Nil Distribution	Corporation Maximum Distribution	Branch
Gross profit	100.00	100.00	100.00
Municipal trade tax	<u>(16.00) (1)</u>	<u>(16.00) (1)</u>	<u>(16.00) (1)</u>
	84.00	84.00	84.00
Corporation tax:			
Undistributed amounts @ 56%	(47.04)	—	—
Distributed amounts @ 36%	—	(30.24) (2)	—
Branch profits @ 50%	<u>—</u>	<u>—</u>	<u>(42.00)</u>
Net	36.96	53.76	42.00
Withholding tax @ 25% (assumed maximum rate)	<u>—</u>	<u>(13.44)</u>	<u>—</u>
Net retained by corporation	36.96	—	—
Net received by parent/head office	<u>—</u>	<u>40.32</u>	<u>42.00</u>
Total taxes paid	<u>63.04</u>	<u>59.68</u>	<u>58.00</u>
Percentage of corporation tax to taxable income (after municipal trade tax)	56.00%	36.00%	50.00%

Notes: (1) Rate assumed as for Frankfurt/Main

(2)  $36\% \times 84.00 = 30.24$

**Comparison of Corporation and Branch Tax Rates  
Prior to 1st January 1977\***

	<b>Corporation Nil Distribution</b>	<b>Corporation Maximum Distribution</b>	<b>Branch</b>
Gross profit	100.00	100.00	100.00
Municipal trade tax	<u>(16.00) (1)</u>	<u>(16.00) (1)</u>	<u>(16.00) (1)</u>
	84.00	84.00	84.00
Corporation tax:			
Undistributed amounts @ 52.53%	(44.13) (2)	(10.84) (3)	—
Distributed amounts @ 15.45%	—	(9.79) (4)	—
		(20.63)	
Branch profits @ 50.47%	<u>—</u>	<u>—</u>	<u>(42.39) (5)</u>
Net	39.87	63.37	41.61
Withholding tax @ 25% (assumed maximum rate)	<u>—</u>	<u>(15.84)</u>	<u>—</u>
Net retained by corporation	39.87	—	—
Net received by parent/head office	<u>—</u>	<u>47.53</u>	<u>41.61</u>
Total taxes paid	<u>60.13</u>	<u>52.47</u>	<u>58.39</u>
Percentage of corporation tax to taxable income (after municipal trade tax)	52.53%	24.57% (6)	50.47%

\*Corporation and branch tax rates in effect prior to the corporation tax reform law.

Notes: (1) Rate assumed as for Frankfurt/Main

(2)  $52.53\% \times 84 = 44.13$

(3)  $52.53\% \times (10.84 + 9.79) = 10.84$  (the shadow effect)

(4)  $15.45\% \times 63.37 = 9.79$

(5)  $50.47\% \times 84 = 42.39$

(6)  $24.57\% \times 84 = 20.63$

This illustration ignores the effect of 'affiliated privilege' and the availability in the recipient's country of credits for foreign withholding and income taxes in accordance with a double taxation agreement.

# Taxation in Germany

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## Withholding Tax Rates on Dividend, Interest and Royalty Payments by German Resident Corporations in Accordance with Various Double Taxation Agreements as at July 1976

Recipient Resident In	Dividends % (1)	Interest % (2)	Royalties %
Australia	15 or 25 (3)	10	10
Austria	25 (4)	Nil	Nil
Belgium	15 or 25 (3)	Nil or 15 (5)	Nil
Canada	15 or 25 (3)	15	15 (6)(7)
Denmark	15 or 25 (3)	Nil	Nil
Finland	25	Nil	Nil
France	15 or 25 (3)	Nil	Nil
Ireland	15 or 25 (3)	Nil	Nil
Italy	25	Nil	Nil
Japan	15 or 25 (3)	10	10
Luxembourg	15 or 25 (3)	Nil	5 (6)
Netherlands	15 or 25 (3)	Nil	Nil
South Africa	15 or 25 (3)(4)	10	Nil
Sweden	15 or 25 (3)	Nil	Nil
Switzerland	15 or 25 (3)(8)	Nil (8)	Nil (7)
UK	15 or 25 (3)	Nil	Nil
USA	15 or 25 (9)	Nil	Nil

### Notes:

- (1) In all cases, tax is initially withheld at 25%. On application, repayment is made to reduce tax rate to 15% if applicable (see Note 3).
- (2) Does not apply to interest on convertible or profit-sharing bonds, which is treated like a dividend, nor to interest on loans secured on immovable property.
- (3) Reduction to 15% is inapplicable if recipient is a corporation that owns 25% or more of voting shares of German corporation and unless difference in split rates of German corporation tax is radically changed.
- (4) Although treaty states rate of withholding may be 25.75%, practically only 25% is withheld as, since 1975, the 3% surcharge is no longer levied.
- (5) 15% tax assessed if interest is paid on debentures or recipient is a corporation owning 25% or more of voting shares of German corporation.
- (6) In addition, 1% net worth tax is payable on value of patents registered in Germany.
- (7) Unless payment is excessive due to close relationship of debtor and creditor.

(8) 25% rate applies if Swiss corporation alone, or together with other members of a group of companies, owns at least 20% of voting shares of German corporation and benefits from cantonal tax reductions.

(9) The normal rate is 15%, unless the reinvestment clause (page 131) applies.

**Illustration of 1976 Income Tax Computation  
of Resident and Jointly Assessed Married Couple with Two Children**

	DM	DM
1. Employment income (husband only):		
Gross amount of compensation in cash or in kind	60,000	
Less allowances	( 580)	
Less standard deductions	<u>( 564)</u>	
		58,856
2. Income from investment of capital:		
Dividends (gross) from German resident corporations (see <i>Note</i> )	10,000	
Interest received	10,000	
Less standard deductions	<u>(800)</u>	
		19,200
3. Income (deemed) from private residence:		
1% of standard value of private residence (as assessed)		
DM 200,000 @ 140%		<u>2,800</u>
Total income		80,856
4. Deductions:		
(a) Provident expenses (maximum allowances for personal insurance and other provident expenses) (assume)	6,400	
(b) Other special expenses:		
Recognised charitable contributions	800	
Church tax paid (including withholding and advance payment)	1,671	
Total personal expenses		<u>8,871</u>
		71,985
Less: Extraordinary charges (assume)		<u>Nil</u>
Taxable Income		<u>71,985</u>

*(continued)*

# Taxation in Germany

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(continued)

	Income Tax DM	Church Tax DM
5. Income tax payable:		
Per table of income tax rates for jointly assessed married couples	21,252	
Church tax calculated on basis of income tax		1,783
Less withholding taxes:		
wage tax	(13,216)	
church tax		(1,059)
capital yields tax		
(25% on dividends — see <i>Note</i> )	(2,500)	
Remaining tax liability	<u>5,536</u>	<u>724</u>
Less income tax and church tax paid in advance for 1976 as assessed (assume)	<u>(4,300)</u>	<u>(612)</u>
Balance of tax payable	<u><u>1,236</u></u>	<u><u>112</u></u>

**Note:**

An imputed credit will be given under the corporation tax reform law for the underlying corporation tax on distributions made by German corporations out of profits for financial periods ending after 31st December 1976.

In the above example, the credit would be  $\text{DM } 10,000 \times \frac{36}{64} = \text{DM } 5,625$ ; gross income liable to tax, however, would be increased correspondingly, with this credit amount being set off against the total tax liability.



- THE CITY AND ITS ECONOMY
- INVESTMENT INCENTIVES
- TRAVEL AND COMMUNICATIONS
- TAX CONSIDERATIONS

### THE CITY AND ITS ECONOMY

The city of Berlin, the capital first of Prussia and then of the whole of Germany from 1870 to 1945, is now completely surrounded by the territory of the German Democratic Republic (GDR). The city is divided by the Berlin 'Wall,' to the east of which is communist East Berlin. On the west side of the Wall are the American, British and French sectors, now governed by their own elected Senate, so that for all practical purposes West Berlin is the equivalent of an eleventh state of the Federal Republic.

West Berlin is a busy, prosperous city with about 2.1 million inhabitants in its 480 square kilometers (186 square miles). New buildings mix with old, and the city is made more amenable by lakes, parks, and vast wooded areas. It has made remarkable progress since 1945, partly with aid from the Federal Government and the European Recovery Programme and partly through the determination of West Berliners to strengthen the position of their beleaguered city.

Economically, West Berlin depends on West Germany, as 82% of West Berlin sales are transacted with West German enterprises and 84% of its supplies originate in the Federal Republic. Furthermore, West Berlin is largely subsidised by the Federal Government. It is noteworthy that in the next three years 37 large corporations have decided to invest DM 1 billion in West Berlin. Currently, the labour force is about 900,000. Electrical engineering and electronics are the most important industries, followed by machinery, food-processing, pharmaceuticals, clothing and precision instruments. Service industries are important not only because of the large population but also because of the 'export' of services, which is particularly promoted (the VAT rebate was revised from 6½% to 10% on 1st April 1976). Tourism is also a significant contributor to the economy.

West Berlin is particularly suitable for research and development work; it has a greater variety of such institutions than anywhere else in Germany. It is also a favourable base from which to conduct business with East European countries, and for this purpose a special information centre is being established in the city.

# West Berlin

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Business conditions in West Berlin are substantially the same as those in the Federal Republic, although the Constitution states that Federal laws apply only after their adoption by the city council. This chapter deals with the additional factors to be considered by an enterprise planning to do business in or with West Berlin.

## INVESTMENT INCENTIVES

German or foreign enterprises that locate in West Berlin may apply for any of a number of investment aids similar to those described in Chapter 2. In addition, special West Berlin tax incentives are available, as detailed later in this chapter. Further information can be obtained from the Zentralstelle für Industrieansiedlung, 1000 Berlin 62, Martin Luther Strasse 105 (tel: (030) 7 83 81 32; telex: 01 83 798).

### Buildings, Plant and Equipment

The investment grant in West Berlin amounts to 10% of the cost of new assets, increased to 25% for movable machinery and equipment.

### Research and Development Expenditure

Investments in approved research and development work are subsidised at 30% of cost. In addition, loans at reduced rates of interest are available from Federal and West Berlin sources for these capital expenditures and research and development projects, and the capital grants described do not reduce cost for tax depreciation purposes.

### Labour Assistance

Employees in West Berlin receive a grant of 8% of their earnings plus an allowance of up to a maximum of DM 22 per month (depending on the wage tax class of the taxpayer) for each child to compensate for some living costs that are higher than elsewhere in West Germany.

## TRAVEL AND COMMUNICATIONS

### Travel to West Berlin

Certain airlines run scheduled services to West Berlin, and normally no difficulties are experienced by travellers arriving by air. A new airport, Tegel, has recently been opened. There are regular train services to the city, and road travel is permitted from approved points. Visitors arriving direct from foreign countries must obtain the documents described in Chapter 4, but for travellers from the Federal Republic, not using air transportation, East German transit visas are required in addition. These may be obtained from the local embassy or consulate of the GDR.

## Staying in the City

There are many hotels, especially in the Kurfürstendamm district, but they tend to be expensive. Registration with the police is not necessary for hotel guests, as notification by the hotel is automatic, but other visitors must inform the police immediately on arrival if they are to stay more than a few days. Travel within West Berlin by taxi, rail or bus is simple, but for visits to East Berlin strict rules must be followed. Certain taxis in West Berlin are permitted to take visitors to the eastern sector of the city, but otherwise foreigners may cross only at one point — by road at the Friedrichstrasse entry, 'Checkpoint Charlie,' or by overhead or underground railway, (*S* or *U-Bahn*), at Friedrichstrasse station, where passport and currency controls are enforced. No East Germany currency should be taken into or out of East Berlin or the GDR, as unauthorised possession of such currency may result in imprisonment. Day visitors to East Berlin require a valid passport, but seldom a visa; for overnight or longer stays or onward travel to East Germany, however, GDR entry and exit visas must be obtained. GDR citizens do not need a West Berlin visa to enter West Berlin.

## Communications

Postal, telephone and telex services between West Berlin and the Federal Republic are good, but between West Berlin and East Berlin or the GDR they are very slow and restricted — a letter may take a week and even a cable may take 24 hours.

## Freight

Goods travelling by surface transport between West Germany and West Berlin require a special way-bill (*Warenbegleitschein*).

## TAX CONSIDERATIONS

Under the West Berlin Aid Law (*Berlinförderungsgesetz*), tax incentives are granted to residents and nonresidents doing business or investing in West Berlin, whether individuals or corporate entities.

### Corporate Income Tax

Corporate income taxpayers, whose principal place of business or management is in West Berlin or who have a permanent establishment there and employ at least 25 persons, are granted a 20% reduction in the corporate income tax payable on assessed taxable income from West Berlin sources. This tax is computed as that for individuals described on page 162. In addition, a tax credit equivalent to 3.2% of gross income, less deductible business expenses, from West Berlin sources is granted.



# West Berlin

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Under the new corporate income tax law, these tax reductions are unchanged, except that the reduction is 10% of the tax on a corporation's income if earned by a permanent establishment in West Berlin.

## Individual Income Tax

Individuals resident or working in West Berlin are given a special 30% tax reduction on the following income from West Berlin sources:

1. Income from agriculture, forestry or business carried on in West Berlin. If the individual has other establishments of the same business elsewhere in the Federal Republic, the West Berlin source income is calculated on the ratio of West Berlin payroll to total payroll.
2. Gains from disposal of real property.
3. Income from personal services rendered in West Berlin.
4. Income from capital, that is, interest on loans if the debtor is located in West Berlin, and similarly, mortgage interest secured on West Berlin real property.
5. Rentals, royalties and other income if the origin of the property, right or source is in West Berlin. The reduction is generally computed by apportioning the amount of tax in the ratio of net West Berlin-source income or business profits to total net income.

## Accelerated Depreciation

Special accelerated depreciation is available in the year of purchase or over the first five years of an asset's life. This amounts to 75% on the cost of movable fixed assets, used for a minimum period of three years in a West Berlin place of business, and also on the cost of buildings used by the business. For residential buildings, the rate is reduced to 50% in the year of purchase or over the first three years. Costs of reconstruction or enlargement of existing premises are also eligible. This accelerated depreciation replaces the normal depreciation charge; but after the five-year period, depreciation is allowed on the written-down value in the normal manner. A tax loss created or increased by this accelerated depreciation may be carried forward within the normal criteria.

## Value Added Tax (VAT)

In West Berlin, the amount of VAT payable by a seller on deliveries to West Germany is reduced by 4.5%, 5% or 6%, depending on the amount

added in West Berlin to the value of the product. For certain services rendered to an enterprise located in West Germany, the reduction is 10%. In addition, a West German customer is entitled to reduce the VAT payable by him by 4.2% of that same price.

## **Special Tax Allowance for Capital Investments**

To encourage capital investment in West Berlin, the following tax advantages are granted to West German resident taxpayers (not necessarily West Berliners):

1. A credit against corporate or individual income tax of 12% of the amount of deposits used to finance capital investments in West Berlin businesses. The credit is available in the year the deposit is made. Only deposits made with either Berliner Industriebank AG or Deutsche Industriebank Berlin for a period of at least eight years, with no repayments taking place before the end of the fourth year, qualify for this special tax treatment.
2. A credit against corporate or individual income tax of 20% of the amount of long-term deposits made to assist the construction of dwellings in West Berlin.

To qualify for these credits, both types of deposit must satisfy other conditions. The total annual credit taken against corporate or individual income tax under these provisions may not exceed 50% of the total tax otherwise payable.

# Notes

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# *Touche Ross International*

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Cable: TOUCHEROSS  
Telex: 232419 TRCO

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Australia  
Belgium/Luxembourg  
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Brazil (1976 edition)  
Canada  
Colombia  
Common Market  
Germany  
Japan (1976 edition)

Malaysia  
Mexico  
The Netherlands  
South Africa  
Spain (1975 edition)  
Switzerland  
Section 482 (transactions  
between related parties)  
United States

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Canberra  
Melbourne  
Newcastle  
Perth  
Surfers Paradise  
Sydney  
Wollongong

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Nassau

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Brussels

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Rio de Janeiro  
Salvador  
Sao Paulo

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Kelowna  
Kitchener  
Langley  
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Montreal  
New Westminster  
Ottawa  
Quebec  
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St. John's  
Saskatoon  
Sydney  
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Vancouver  
Victoria  
Windsor  
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## CHANNEL ISLANDS

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Esbjerg  
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Bremen  
Dusseldorf  
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Hanover  
Munich  
Nuremberg  
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Holsteinsborg

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Agana

## GUATEMALA

Guatemala

## HONG KONG

Hong Kong

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Jakarta  
Medan  
Surabaya

## IRAN

Tehran

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Dublin  
Limerick

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Milan

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Kingston  
Montego Bay

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Kobe  
Kyoto  
Nagoya  
Naha (Okinawa)  
Osaka  
Sendai  
Takamatsu  
Tokyo

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Kuwait City

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Beirut

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Kuala Trengganu  
Kuantan  
Kuching  
Penang

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Port Louis

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Mexico City  
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## NETHERLANDS

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Almelo  
Amersfoort  
Amsterdam  
Arnhem  
Beverwijk  
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Eindhoven  
Enschede  
Gouda  
Groningen  
Haarlem  
The Hague

Heerlen  
Hilversum  
Leeuwarden  
Middelburg  
Nijmegen  
Rijswijk  
Rotterdam  
Terneuzen  
Tilburg  
Zwolle

## NETHERLANDS ANTILLES

Curacao

## NEW ZEALAND

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Christchurch  
Wanganui  
Wellington

## NICARAGUA

Managua

## NORWAY

Moss  
Oslo  
Sandefjord

## PANAMA

Panama

## PAPUA NEW GUINEA

Lae  
Port Moresby  
Rabaul

## PERU

Lima

## PUERTO RICO

San Juan

## RHODESIA

Bulawayo  
Salisbury  
Umtali

## SAUDI ARABIA

Jeddah  
Riyadh

## SINGAPORE

Singapore

## SOUTH AFRICA

Cape Town  
Durban  
Johannesburg  
Pietermaritzburg  
Port Elizabeth

## SPAIN

Barcelona  
Madrid

## SURINAM

Paramaribo

## SWEDEN

Stockholm

## SWITZERLAND

Geneva  
Zurich

## TRINIDAD AND TOBAGO

Port of Spain

## TURKEY

Istanbul  
Izmir

## UNITED ARAB EMIRATES\*

Abu Dhabi  
Dubai  
Sharjah

## UNITED KINGDOM

Belfast  
Birmingham  
Bristol  
Edinburgh  
Glasgow  
Leeds  
Leicester

Liverpool

London  
Manchester

## UNITED STATES OF AMERICA

Akron, Ohio  
Albuquerque, New Mexico  
Anchorage, Alaska  
Atlanta, Georgia  
Austin, Texas  
Baltimore, Maryland  
Birmingham, Alabama  
Bloomfield Hills, Michigan  
Boise, Idaho  
Boston, Massachusetts  
Buffalo, New York  
Charlotte, North Carolina  
Chicago, Illinois  
Cincinnati, Ohio  
Cleveland, Ohio  
Colorado Springs, Colorado  
Columbus, Ohio  
Corpus Christi, Texas  
Dallas, Texas  
Dayton, Ohio  
Denver, Colorado  
Detroit, Michigan  
Elizabethtown, Kentucky  
Fresno, California  
Grand Rapids, Michigan  
Hackensack, New Jersey  
Harrisburg, Pennsylvania  
Honolulu, Hawaii  
Houston, Texas  
Jackson, Mississippi  
Jacksonville, Florida  
Kansas City, Missouri  
Lincoln, Nebraska  
London, Kentucky  
Los Angeles, California  
Louisville, Kentucky  
Melville, New York  
Memphis, Tennessee  
Miami, Florida  
Milwaukee, Wisconsin  
Minneapolis, Minnesota  
Morristown, New Jersey  
Nashville, Tennessee  
Newark, New Jersey  
New Orleans, Louisiana  
New York, New York  
Oakland, California  
Oklahoma City, Oklahoma  
Omaha, Nebraska  
Philadelphia, Pennsylvania  
Phoenix, Arizona  
Pittsburgh, Pennsylvania  
Pocatello, Idaho  
Portland, Oregon  
Richmond, Virginia  
Rochester, New York  
Sacramento, California  
St. Louis, Missouri  
Saint Paul, Minnesota  
Salem, Oregon  
Salt Lake City, Utah  
San Antonio, Texas  
San Diego, California  
San Francisco, California  
San Jose, California  
Santa Ana, California  
Santa Rosa, California  
Seattle, Washington  
Stamford, Connecticut  
Tampa, Florida  
Toledo, Ohio  
Tulsa, Oklahoma  
Washington, D.C.  
Worcester, Massachusetts

## VENEZUELA

Caracas  
Maracaibo

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